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CERTAIN TARIFF AND TRADE BILLS

COMPLETED
762

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

FEBRUARY 6 AND 7, 1986

Serial 99-69

Printed for the use of the Committee on Ways and Means

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CERTAIN TARIFF AND TRADE BILLS

THURSDAY, FEBRUARY 6, 1986

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[The press releases announcing the hearing follow:]

[For immediate release Friday, January 24, 1986]

Hon. Sam M. Gibbons (D., Fla.), Chairman, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, Announces a Hearing on Certain Tariff and Trade Bills, February 6, 1986

Hon. Sam M. Gibbons (D., Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will hold a hearing on Thursday, February 6, 1986, on certain tariff and trade bills to provide permanent duty-free entry, temporary suspension of duty, duty increase, classification changes, and other bills. The hearing will be held in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

Officials from interested Executive branch agencies will be the first witnesses. Testimony also will be received from interested private sector witnesses.

The tariff and trade bills on which testimony will be received are listed below:

DUTY SUSPENSION BILLS

H.R. 2225 (Mr. Blaz and Mr. Frenzel): Relating to the customs treatment of certain wearing apparel produced in the insular possessions of the United States.

DUTY-FREE BILLS

H.R 2885 (Mr. Gibbons, by request): To implement the Nairobi Protocol to the Florence Agreement on the Importation of Educational, Scientific, and Cultural Materials, and for other purposes.

DUTY INCREASE BILLS

H.R. 2336 (Mr. Guarini, Mr. Vander Jagt, Mr. Russo, Mr. Schulze, et al): To impose a duty on uranium hexafluoride (UF6) imported from any country that requires the processing of uranium mined in that country into UF6 before export.

H.R. 2354 (Mr. Anthony, Mr. Duncan, et al): To amend the Tariff Schedules of the United States with respect to motor fuel, motor fuel blending stock, and naphthas, and for other purposes.

H.R. 2849 (Mr. Young of Alaska): To increase the rate of duty on gasoline and motor fuel blending stock, and for other purposes.

CLASSIFICATIONS BILLS

H.R. 2349 (Mr. Rostenkowski, et al): To amend the Tariff Schedules of the United States regarding the classification of television apparatus and parts thereof.

H.R. 2396 (Mr. Matsui, et al): To change the tariff treatment with respect to naptha and motor fuel blending stocks.

H.R. 2913 (Mr. Quillen): To amend the Tariff Schedules of the United States to provide for rates of duty on imported speedometers used on exercise equipment consistent with those on bicycle speedometers.

CUSTOMS AND OTHER NONTARIFF BILLS

H.R. 839 (Mr. Schulze): Relating to the marking of containers of imported mushrooms.

H.R. 1004 (Mr. Pease, et al): To amend the National Traffic and Motor Vehicle Safety Act of 1966 to establish procedures under which any person may petition for an investigation (including testing and inspection) regarding any automobile manufacturer's certification of compliance with vehicle safety standards, and to permit suspension of importation of vehicles pending the outcome of such investigation. (Also referred to the Committee on Energy and Commerce.)

H.R. 1006 (Mr. Rinaldo, Mr. Campbell, Mr. Schulze, Mr. Duncan, et al): To amend the National Traffic and Motor Vehicle Safety Act of 1966 with respect to certain passenger motor vehicle safety requirements, and for other purposes. (Also referred to Committee on Energy and Commerce.)

H.R. 1566 (Mr. Leach of Iowa. Mr. Heftel, et al): To ensure payment of the additional duty imposed on ethyl alcohol used as a fuel or in making gasohol.

H.R. 1567 (Mr. Leach of Iowa, Mr. Heftel, et al): To exclude from the Caribbean Basin Economic Recovery Act ethyl alcohol used for feul which is merely distilled or denatured in a beneficiary country.

H.R. 1720 (Mr. Durbin, Mr. Heftel, Mr. Gephardt, Mr. Dorgan, et al): To ensure payment of the regular duties imposed on imported ethyl alcohol and payment of the additional duty imposed on ethyl alcohol when imported for use in producing a mixture of gasoline and alcohol or used otherwise as fuel.

H.R. 2028 (Mr. Anthony, Mrs. Kennelly, and Mr. Rowland of Conn.): To render watches eligible for preferential treatment under title V of the Trade Act of 1974.

H.R. 2029 (Mr. Anthony, Mrs. Kennelly, and Mr. Rowland of Conn.): To amend the Tariff Schedules of the United States in order to eliminate the special marking requirements for imported watches and clocks and components thereof.

OTHER BILLS

H.R. 3019 (Mr. Gibbons, by request): To amend the Tariff Schedules of the United States to permit the importation of furskins from the Union of Soviet Socialist Republics.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Requests to be heard must be made by telephone to Harriett Lawler [telephone (202) 225-3627] by noon, Friday, January 31, 1986. The request should be followed by a formal written request addressed to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

In view of the number of bills to be reviewed and the limited time available, witnesses wishing to present oral testimony are requested to briefly summarize their written statements. The full statement will be included in the printed record

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 150 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearances. Failure to do so may result in the witness being denied the opportunity to testify in person because of the number of bills involved.

Each statement to be presented to the Subcommittee or any written statement submitted for the record must contain the following information:

(1) The name, full address, and capacity in which the witness will appear (as well as a telephone number where the witness or a designated representative may be reached);

(2) A list of any clients or persons, or any organization for whom the witness appears; and

(3) A topical outline or summary of the comments and recommendations in the full statement.

WRITTEN STATEMENT IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit six (6) copies of their statement by the close of business Thursday, February 13, 1986, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing a written statement for the record of the printed hearing wish to have their statement distributed to the press and the interested public, they may provide 75 additional copies for this purpose during the course of the public hearing.

[For immediate release, Tuesday, February 4, 1986]

HON. SAM M. GIBBONS (D., FLA.), CHAIRMAN, SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES AN ADDITIONAL HEARING DAY ON CERTAIN TARIFF AND TRADE BILLS, FEBRUARY 7, 1986

Hon. Sam M. Gibbons (D., Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced that due to the large number of requests to be heard at the hearing on certain tariff and trade bills scheduled for Thursday, February 6, 1986, an additional day has been scheduled on Friday, February 7, 1986. Friday's hearing will be held in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m., and concluding no later than 2:00 p.m.

The tariff and trade bills on which testimony will be received on Friday are listed below:

H.R. 1566 (Mr. Leach of Iowa, Mr. Heftel, et al): To ensure payment of the additional duty imposed on ethyl alcohol used as a fuel or in making gasohol.

H.R. 1567 (Mr. Leach of Iowa, Mr. Heftel, et al): To exclude from the Caribbean Basin Economic Recovery Act ethyl alcohol used for fuel which is merely distilled or denatured in a beneficiary country.

H.R. 1720 (Mr. Durbin, Mr. Heftel, Mr. Gephardt, Mr. Dorgan, et al): To ensure payment of the regular duties imposed on imported ethyl alcohol and payment of the additional duty imposed on ethyl alcohol when imported for use in producing a mixture of gasoline and alcohol or used otherwise as fuel.

All other details for Friday's hearing are the same as announced for Thursday's hearing (see Subcommittee Press Release No. 15).

Chairman GIBBONS. Good morning.

This is the meeting of the Subcommittee on Trade of Ways and Means. This is just the first of a whole series of hearings we are going to have this year.

Last year was the "year of the tax" and this year will be the "year of the trade". We haven't exactly decided how we are going to handle all the bills that we have here.

As you recall from the past, it has been our custom to package some of the least controversial bills and to put them together in one package and send them to the Senate in that kind of package. We will probably do some of that. As I say, we haven't figured out exactly how we are going to handle the agenda this year as far as technically handling these bills, but we want to get started on the substance of them and go through that process first, give everybody an opportunity to be heard and to get us thoroughly acquainted with the situation.

Our first witness this morning is the very distinguished Secretary of Commerce, Mr. Malcolm Baldrige. We are anxious to have you here.

We are going to work real hard for the next couple of days. We have to quit by 2 p.m. tomorrow because of plane schedules and things of that sort. Anybody we should miss, we will pick you up a little later on along the road.

Thank you very much, Mr. Secretary, for coming this morning and you and I are going to talk about something that is close to both of our hearts and that is fur skins.

We appreciate you coming to help us with this subject.

STATEMENT OF HON. MALCOLM BALDRIGE, SECRETARY OF COMMERCE

Secretary BALDRIGE. Thank you very much, Mr. Chairman.

As you know, we have a time problem this morning. I have to leave at 10.

Chairman GIBBONS. We will have you gone.

Secretary BALDRIGE. I thought I would just submit the written statement for the record, if that is all right with you, Mr. Chairman.

Chairman GIBBONS. All right, sir.

Secretary BALDRIGE. I made a trip to the Soviet Union last May and we had the first meeting—after a 7-year hiatus—with the Soviets on our Joint Trade Commission. We have had a lot of problems in our two-way trade for the last 7 years and do not have a forum to talk them over. This established that procedure again.

A lot of the American companies felt that they had been completely excluded from opportunities to bid in the Soviet Union. We asked first and foremost that Americans be put on the bid list, have an equal opportunity with everybody else to bid on Soviet projects, and we asked that those bids be considered on economic merits alone, not political reasons.

The Soviets agreed and furthermore implemented that agreement by Minister Patolichev, the Trade Minister at that time, writing a letter to the Foreign Trade Organization of the Soviet Union in effect saying Americans should be on the bid list, No. 1, and No. 2, bids should be considered on economic merits alone.

They went further in opening up some other areas to us that had to do with support services, offices, abilities to have trade shows, and so forth. On our side we have offered them the same kinds of trade courtesies in this country and said that the administration would support a repeal of this 34-year-old fur skin ban which we feel is more of a symbolic gesture than an actual, meaningful trade measure. We don't think the consequences will be very strong compared to what has been going on.

With that, Mr. Chairman, I would be glad to answer any questions you have.

[The prepared statement follows:]

STATEMENT OF HON. MALCOLM BALDRIGE, SECRETARY OF COMMERCE

I am here today to discuss H.R. 3019, a bill which would remove an import embargo on seven types of Soviet furskins. President Reagan considers this legislation an important part of his effort to build a more constructive relationship with the Soviet Union, and I strongly concur.

Passage of H.R. 3019 would be a modest, but concrete, step to remove a long-standing irritant in United States-Soviet trading relations. This action will serve as a demonstration of United States willingness to remove obstacles to a more productive bilateral relationship in the interest of both countries.

H.R. 3019 is in the economic interest of the United States. The Soviet Union has agreed to take steps which will lead to a significant increase in U.S. exports. Trade with the U.S.S.R. last year produced a $2 billion surplus, our fourth largest with any country. On the other hand, removal of the embargo should have little or no impact on the U.S. fur industry.

RELATIONS WITH THE SOVIET UNION

Two years ago President Reagan established three major objectives for United States-Soviet relations: (1) to reduce, and eventually eliminate, the threat and use of force in solving international disputes; (2) to reduce arms stockpiles; and (3) to establish a better working relationship between the two countries.

The President decided that expansion of peaceful trade which benefits both parties should be a part of our effort to build a better working relationship with the Soviet Union. By "peaceful trade," we mean nonstrategic trade consistent with existing U.S. laws and policies. Strategic goods and technology are proscribed by U.S. export controls and the multilateral controls which we maintain along with our allies. Trade in strategic goods and technology is not a topic on the table for discussion. However, the United States can benefit from increased peaceful trade through more exports and jobs.

UNITED STATES-SOVIET TRADE

At the direction of the President I went to Moscow last May for the first meeting in 7 years of the joint U.S.-U.S.S.R. commercial commission. I told the Soviets of the President's desire to see peaceful trade grow, and proposed that both sides should take some initial steps to improve the trade relationship where that was possible.

I told them that U.S. companies felt they had been virtually frozen out of the Soviet market, and that the first thing that had to happen was for the Soviet side to open up their market to American firms.

My counterpart, Foreign Trade Minister Patolichev, agreed to send an unprecedented letter to Soviet foreign trade organizations ensuring they would provide bid invitations to all interested U.S. firms, provide American companies with access to appropriate Soviet officials, and consider American company proposals on their economic merits.

Since May, U.S. companies have reported a sharp change. They are receiving bid inquires. They are getting in to see Soviet officials. And they are being asked to come up with new proposals.

Most significantly, Soviet orders for machinery and equipment from U.S. firms are running far above the previous level. They totalled about $240 million in 1985, compared to only about $70 million in 1984. Those new orders, incidentally, mean more than five thousand new jobs in U.S. manufacturing firms.

The number of new business possibilities under discussion between United States firms and Soviet trade organizations continues to grow, and success here will mean even more export growth. But in order to maintain this progress, we have to show some movement on our side. We can't expect this to be a one-way street.

Realistically, there are very few steps we can take. Changes in controls on strategic trade are out of the question. Extension of MFN is linked to emigration

THE EMBARGO ON SOVIET FURSKINS

One modest step we could take, however, would be to end the 1951 embargo on imports of seven types of Soviet furskins. The embargo originally applied both to the Soviet Union and to the People's Republic of China. Legislation signed into law in 1983, however, removed the ban from the PRC. In consideration of Soviet steps to open their market to U.S. firms, I announced in Moscow that the administration would propose legislation to remove the furskin embargo.

This action would have very significant symbolic importance. It would demonstrate the willingness of the President and the Congress to take concrete steps to improve the bilateral relationship where that is possible.

According to fur industry sources, removal of the import ban on Chinese furskins has had little or no impact on our domestic industry. Our analysts expect removal of the Soviet embargo to also have little or no impact on the domestic fur industry.

Four of the seven furskins—ermine, kolinsky, weasel, and muskrat—have been exported from the Soviet Union in very limited quantities, or not exported at all in recent years. The Soviet industry is mature and has not seen production increases.

In discussions with representatives of fur industry interests, the greatest concern has been expressed regarding mink, fox and muskrat. United States and Soviet mink and fox furskins generally compete in different market segments. U.S. ranchers produce the world's highest quality mink. More than 80 percent of U.S. mink production is exported, competing with Soviet and other furs in the world market.

U.S. fox is mostly trapped and would not be in direct competition with Soviet fox, which is ranch-raised, and therefore of different quality. The Soviet Union has exported no muskrat since 1982.

U.S. furskins already compete with Soviet furskins, which can enter the U.S. market after being made into apparel in other countries. I should also note that to the extent that soviet furskins entered the U.S. market instead of imported garments made from those furskins, American processors and garment makers would benefit.

CONCLUSION

Mr. Chairman, let me conclude by repeating that removal of the fur embargo is in the interest of the United States. The steps undertaken by the soviets are leading to increased U.S. exports that are already creating thousands of U.S. jobs, while analysis indicates there will be little or no effect on the domestic furskin industry.

Removal of the ban will show that we are able to take concrete actions to support President Reagan's policy of attempting to establish a more constructive working relationship with the Soviet Union in areas of mutual interest. This is particularly important as we follow up on the meeting in Geneva between the President and General Secretary Gorbachev.

Thank you, Mr. Chairman.

Chairman **GIBBONS**. Fine. We appreciate you coming in support of this legislation this morning, Mr. Baldrige.

As you know, I have introduced it at the administration's request and we intend to try to move it as rapidly as we can. I don't know where the votes are on this committee, but I hope that we can get them—get enough of them. I agree with you, this is more symbolism than it is substance, but it is important symbolism to get a better understanding and a better movement in this area.

Mr. Frenzel, do you have some questions?

Mr. **FRENZEL**. I do.

First, I would like to reaffirm your statements, Mr. Chairman, and thank the Secretary for moving forward on what I think is an important symbolic part of whatever we are engaged in now on all fronts with the USSR, whether it is détente or a thank you or whatever. I hope it goes forward.

I have a question, and that is that you refer to a number of furs, but not sable. Is that not included?

Secretary **BALDRIGE**. Well, sable is able to be imported now from the USSR.

Mr. **FRENZEL**. That is not under the ban?

Secretary **BALDRIGE**. No. That is not under the ban. We imported about 74 million sable skins last year.

Mr. **FRENZEL**. Thank you.

Secretary **BALDRIGE**. I am sorry—74,000. Everybody in this room would be wearing a sable otherwise.

Mr. **FRENZEL**. The President's state of the Union address was restrained, if that is true.

We are really doing well on that.

Secretary **BALDRIGE**. Please let the record show 74,000.

Mr. **FRENZEL**. I again repeat what the chairman said, and I hope this becomes a part of our package. We are going to do a good job of getting you out of here on time.

I yield the balance of my time.

Chairman **GIBBONS**. I enjoy working with all your folks. They are fine people, Mr. Secretary.

Secretary **BALDRIGE**. Thank you.

Chairman Gibbons. In the Gramm-Rudman area, please do as much as you can to facilitate timely processing under the export administration program.

Thank you very much.

Secretary Baldrige. If I may make a point here that I didn't make before, Mr. Chairman.

Chairman Gibbons. Sure.

Secretary Baldrige. The reason I went to the Soviet Union in May and again in December last year is because of the President's overall program in increasing our relationships with the Soviet Union. He looks on trade as one of the elements that go into that relationship. It is an important one. Trade relations itself can never dominate our overall relations with the Soviet Union simply because we are two superpowers and there are other, more important areas we have to agree on. But it certainly is an important area.

It can lead the way to better relationships. It cannot dominate those relationships or get too far out in front; but, in trying to open up all kinds of areas with the Soviets, obviously arms control, cultural exchange and so forth, trade is, we feel, an important one and that was one of the reasons for this effort.

Chairman Gibbons. I agree and I applaud you.

Anybody that goes to the Soviet Union in December has my great admiration. It is certainly not a touristy trip at that time of the year.

Secretary Baldrige. No, sir.

Chairman Gibbons. I agree that trade will not always be a large factor, but it will help build understanding and perhaps help build confidence where we so badly need both understanding and confidence.

Mr. Frenzel. Mr. Chairman, it might be a good thing for the verbal record and as a part of the Secretary's statement, to simply repeat that this is—this does not change the tariffs at all. The Soviets would still get the most-unfavored-nation tariff treatment. All we are doing is repealing an import ban on these products.

Secretary Baldrige. That is exactly correct. This has nothing to do with the most-favored-nation status. The Soviets understood that that depends on emmigration, human rights movements and so forth.

This is just repealing a ban for the last 35 years on several types of fur skins. This is an area, incidentally, where the American industry competes very successfully abroad with the Soviets. That is why we don't feel that there will be a marked impact on lifting this ban.

Chairman Gibbons. Fine.

At this point I will introduce Secretary Shultz' statement. He has written us a letter endorsing this proposal, too, and I don't guess Cap Weinberger has got any public objection to it, has he?

Secretary Baldrige. Well, I think he has been busy enough with other areas lately. I haven't heard of any.

Chairman Gibbons. All right. Fine.

I assumed when you said it was endorsed by the administration, that included everybody?

Secretary Baldrige. Yes, it is. It is endorsed by everybody.

Chairman **Gibbons**. Thank you, sir.

Secretary **Baldrige**. Thank you, Mr. Chairman.

[The letter follows:]

The Secretary of State,
Washington, DC, February 5, 1986.

Hon. Sam Gibbons,
Chairman, Subcommittee on Trade,
Committee on Ways and Means, House of Representatives.

Dear Mr. Chairman: I wish to inform you of my support for H.R. 3019 which would remove the 1951 ban on the entry of certain Soviet furskins into the United States. This legislation is about to be considered by the Trade Subcommittee of the Ways and Means Committee.

The Administration informed the Soviets that we would propose the removal of this ban in May 1985, when Secretary Baldrige visited Moscow to attend the meeting of the Joint U.S.-Soviet Commercial Commission. At that time the Soviets assured Secretary Baldrige of their willingness to take actions to improve market access for U.S. firms seeking to trade with the U.S.S.R. In the following months we have begun to see an improvement in the competitive conditions for U.S. companies seeking to export to the Soviet Union and an increase in their level of business.

The termination of our ban on Soviet furskins is a step which has considerable symbolic significance at this stage of our relations. Most importantly, it will show that we are able to take concrete actions to support the President's policy of attempting to establish a more constructive working relationship with the Soviet Union in areas of mutual interest. For this reason we very much hope that your committee, and the full House, will endorse this proposal.

Sincerely yours,

George P. Shultz.

Chairman **Gibbons**. We have next a whole host of folks from the U.S. Department of Commerce. Listed first is Mr. Louis J. Murphy, who is the Acting Director of the Office of Industry Assessment and he is accompanied by a great many fine people.

Mr. Murphy, do you want to make a statement or do you just want to sit here and talk about each one of these bills as we go through them?

STATEMENT OF LOUIS J. MURPHY, ACTING DIRECTOR, OFFICE OF INDUSTRY ASSESSMENT, U.S. DEPARTMENT OF COMMERCE, ACCOMPANIED BY MICHAEL HATHAWAY, DEPUTY GENERAL COUNSEL, U.S. TRADE REPRESENTATIVE; RICHARD W. MILLER, ECONOMIC ADVISER, OFFICE OF TERRITORIAL AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE INTERIOR; EDMOND MISSIAEN, DEPUTY DIRECTOR FOR ANALYSIS, HORTICULTURAL AND TROPICAL PRODUCTS, FOREIGN AGRICULTURAL SERVICE, AND EARLE GAVITT, DIRECTOR, OFFICE OF ENERGY, U.S. DEPARTMENT OF AGRICULTURE; ARTHUR I. RETTINGER, ACTING ASSISTANT CHIEF COUNSEL, U.S. CUSTOMS SERVICE; AND JANIS SUMMERS, ATTORNEY ADVISER, OFFICE OF TARIFF AFFAIRS AND TRADE AGREEMENTS, U.S. INTERNATIONAL TRADE COMMISSION

Mr. **Murphy**. Thank you, Mr. Chairman.

If you do not have any objection, I would like to just review the administration's position on each bill.

Chairman **Gibbons**. All right. Fine.

Mr. **Murphy**. Then open to any questions.

Chairman **Gibbons**. Will you leave somebody behind here?

Mr. **Murphy**. I will be here and so will the rest of the panel. On H.R. 2028, the administration has no position at this time. We are continuing to discuss our position on this legislation and will transmit the administration position as soon as possible.

Mr. **Frenzel**. Mr. Chairman, might I ask if there is a computable Customs revenue impact on these bills?

Mr. **Murphy**. Yes, sir. On H.R. 2029, again, we do not have a position at this time. We are continuing to look into the issue. Among the issues we are looking into is whether some of the special markings which are addressed by the bill, are necessary to implement our anti-counterfeiting laws effectively. We will develop our position and respond to the committee as soon as possible.

On H.R. 2225, the administration strongly supports the purpose and its intended results, that is, to grant relief to the territories from duties that would apply to apparel imported from the territories which are subject to a quota waiver.

We suggest, however, that the means of providing the proposed duty relief be changed. Instead of amending general headnote 3(a) of the Tariff Schedules, we propose adding to the appendix a temporary suspension of the tariff for a 10-year period ending in 1995, on products subject to quota waiver, and meeting the 50 percent foreign value limitation waiver.

Reasons for this suggestion are: first of all, a permanent change in headnote 3(a) is not necessary for a problem that may be temporary. Second, it would be inappropriate to establish more than one rule of origin for a single class of imported articles and, third, and finally, a suspension of duty makes it clear that quotas will not be affected.

We also have proposed a local labor requirement to apply to those sweaters exempted from duty under the proposed bill.

With regard to H.R. 2349, the administration is sympathetic with the intent of this proposed legislation. While the administration cannot support the bill as written, we agree with restoring the former tariff classification of television and television picture tubes. Restoring the pre-1979 tariff nomenclature, with appropriate legislative history should reverse or materially alter the 1981 Customs Service ruling. Such reversal should substantially resolve the concern of the domestic television picture tube industry.

We will work with committee staff and with industry representatives so that these objectives may be met while paying heed to the international obligations of the United States under the GATT.

With regard to H.R. 2354, the administration opposes enactment of this bill. Enactment of H.R. 2354 would significantly increase current tariff levels for motor gasoline, which are bound under the GATT.

With regard to H.R. 2396, the administration has no objection to enactment of this bill.

H.R. 2396 is similar to proposals in the last Congress, which we supported, to establish a new tariff line item for multifuel blending stocks.

On H.R. 2849, the administration strongly opposes enactment of this bill. It is difficult, at best, to forecast petroleum demand and supply from which impact requirements can be estimated, even in an environment of stabilized price levels and an absence of Government intervention. It is virtually impossible to develop accurate forecasts in relation to a complex tariff quota system which would itself introduce severe distortions into the market.

In addition to these technical and administrative problems, the proposed duty rate increases in H.R. 2849 represent a serious departure from our obligations under the GATT and certain bilateral treaties. Most of the principal sources of gasoline imports are GATT members who could request compensation for the duty increases or seek authority to retaliate against U.S. exports. Thus, other industries would have to pay for this additional protection for the U.S. refining industry by facing higher tariffs or quotas for their exports to the countries hurt by our increased gasoline tariffs.

On H.R. 2913, the administration proposes enactment of this bill. Passage could be detrimental to the 13 U.S. manufacturers of exercise bicycles who in 1982 had product shipments of $83 million. The U.S. market for exercise bicycles is growing rapidly and U.S. manufacturers already face stiff price competition from Far East suppliers who benefit from lower labor costs.

The increased production costs that U.S. exercise cycle manufacturers would experience could result in a decrease in sales of U.S. made exercise cycles and a loss of U.S. jobs.

Increasing the tariff on speedometers for exercise equipment would not make the U.S. domestic industry more competitive. There are only two domestic manufacturers of speedometers. NS International, Ltd., is a newly established Japanese-owned assembly facility that makes speedometers priced below imports from the Far East. Hence, raising the tariff rate would not increase their volume of business.

Stewart-Warner is the only other domestic manufacturer of speedometers for exercise equipment. Stewart-Warner's speedometers are priced more than 60 percent above the landed cost of speedometers from Taiwan, Korea and Japan. Therefore, an 18.3 percent duty would not make Stewart-Warner's product price competitive.

We also note that no provision is made in the bill for the staged tariff reductions agreed to in the Tokyo round of trade negotiations.

On H.R. 839, the administration opposes enactment. This legislation imposes labeling requirements for imported, preserved mushrooms that differ from the labeling requirement for other imported articles. It would also impose an additional, unnecessary burden on importers of preserved mushrooms.

The administration opposes enactment of H.R. 2336. This is aimed at current Canadian export policies which the administration is seeking to change. At the Quebec summit last March, the President and the Prime Minister of Canada pledged to work together to reduce or eliminate barriers to energy trade between the two countries. Already substantial progress has been made for mutual reduction of barriers to trade in crude petroleum.

We believe the appropriate means of responding to Canadian programs in the energy area which adversely affects U.S. industry is in the broader context of our bilateral energy trade discussions.

Enactment of H.R. 2336 also would represent a departure from our obligations under the GATT. Countries affected by this change could request compensation for the duty increases or seek authority to retaliate against U.S. exports.

With regard to the three bills on ethanol—ethyl alcohol—H.R.'s 1566, 1567, and 1720, we understand the intent of these bills is to prevent alleged avoidance of the 60-cent-per-gallon duty on ethanol intended for fuel use. The issues of ethanol domestic benefit programs, tariff levels and tariff schedule classifications are very complex and only partly addressed by these bills. The future of ethanol in the U.S. gasoline market is far more affected by the world price of oil and environmental regulations on gasoline additives than it is by these tariff questions.

Nevertheless, we believe it is important to try to resolve these problems in a manner that is consistent with the objectives of the Caribbean Basin Initiative and the domestic ethanol program, both of which programs are mandated by the Congress.

To assist in trying to develop an approach which is consistent with the objectives of both these programs, we will be happy to work with the subcommittee staff on alternatives to the approach contained in these bills which we must oppose in their present form.

The administration opposes enactment of H.R. 1004 because it would create an unnecessary regulatory burden on U.S. industry without producing significant benefits to consumers. In addition, the legislation could be used to restrict U.S. commerce in a discriminatory manner.

Current U.S. regulation of motor vehicle safety is based on self-certification by both domestic and foreign manufacturers of their compliance with federally mandated standards. This system has proven successful in protecting consumers while minimizing the regulatory burden on vehicle producers.

We are especially concerned about the provisions of H.R. 1004 that would authorize the National Highway Traffic Safety Association to prevent U.S. introduction into U.S. commerce of automobiles which are the subject of safety investigations. These provisions could cause serious economic hardship to domestic manufacturers whose vehicles came under investigations and their U.S. dealers, since a single model line generally includes thousands of vehicles.

In addition, H.R. 1004 would authorize the National Highway Traffic Safety Administration to suspend importation of vehicles subject to a safety investigation. This provision could be subject to abuse and applied in a way that discriminates against foreign manufacturers that sell automobiles in this country.

With regard to H.R. 1006, the administration opposes enactment of this bill. H.R. 1006 could effectively bar the importation of grey market cars that are not imported through authorized channels.

The administration is opposed to legislative restrictions on grey market products, per se. We do not believe that grey market imports are a problem of sufficient stature to merit legislation at this time. The interests of the consumer could be adversely affected. The falling dollar will relieve much of the pressure on domestic distributors in any event.

If there is a safety problem presented by the importation of cars which are not manufactured to U.S. specifications, the Department of Transportation will address this problem through its safety programs and strict enforcement of its existing regulatory requirements.

The administration strongly supports enactment of H.R. 2885. Enactment of this bill is necessary in order to permit ratification and continued implementation of the terms of the Nairobi protocol which extends the duty-free treatment for educational, scientific, and cultural materials first accorded under the Florence Agreement to cover a number of new areas and technologies.

This legislation would significantly benefit handicapped individuals as well as educational, scientific and cultural organizations. By easing the access of the handicapped to devices and products specifically adapted to their use, the bill will further the administration's efforts to speed the integration of our handicapped citizens into the mainstream of American life.

Mr. FRENZEL. Mr. Chairman, we are doing bills that aren't on our schedule. Do you have a schedule date for these?

Chairman GIBBONS. We received different kinds of requests, Mr. Frenzel.

Mr. FRENZEL. Thank you. The staff advised me, as they did you. I withdraw the question.

Mr. MURPHY. Mr. Chairman, I have completed our testimony. If there are any questions, the panel and I would be happy to respond to them.

Chairman GIBBONS. I think we could save time if we take each one of these bills one at a time, and wait until we got to them. If you all could stay real close, we will call on you, and if you want to come up to the table while we are talking about some of these and intervene, we will be happy to do it.

We will kind of reserve one of those microphones over there for you. We will find a place for you.

We will now go to our public witnesses. If you would keep your testimony to 5 minutes, we would appreciate it. Our first witness is Mr. Anthony, H.R. 2028, our very distinguished colleague. We are happy to have you here.

STATEMENT OF HON. BERYL ANTHONY, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. ANTHONY. Should I proceed?

Chairman GIBBONS. Go right ahead.

Mr. ANTHONY. Thank you, Mr. Chairman. I want to thank you for the opportunity to testify on two bills that I have introduced along with Congresswoman Barbara Kennelly and Congressman Rowland, H.R. 2028 and H.R. 2029.

The purpose of H.R. 2029 is to remove watches from the statutory lists of products ineligible for duty-free treatment under the generalized system of preferences. There are two principal reasons to remove watches from this exclusion: (1) there is no longer any domestic watch assembly in the United States, and (2) by making watches eligible for GSP, we will be making U.S. firms more competitive with competitors in the Far East, thereby benefiting consumers and protecting U.S. jobs.

Under the Trade Act of 1974, Congress authorized the granting of preferential duty-free treatment for developing countries through GSP. Excluded from this program were watches, since at that time, it was believed GSP treatment could prove destructive to the domestic watch industry. Now, times have changed. There is no longer a watch assembly industry in the United States. Timex is the last significant watch company in the United States with operations in Connecticut and Arkansas. Timex currently employs 1,400 workers in the manufacture of watch parts, design, R&D, and management in the United States. Of the total costs of sales of watches assembled by Timex overseas for sale in the United States, approximately 60 percent is U.S. content. Timex is still subject to major competition from the Far East. However, duty-free treatment would help Timex compete more effectively with foreign suppliers. With the savings provided by GSP, Timex could increase its expenditures for research, engineering, and technology. These increased expenditures would be passed on to U.S. companies involved in research and engineering. Additionally, many U.S. suppliers will benefit from increased watch sales as a result of GSP treatment since Timex purchases over $20 million in components and operating supplies from U.S. producers.

Finally, watches supplied by Timex and other watch companies in GSP countries supply the very low end of the market. Any savings realized through GSP treatment will be most beneficial to low and middle consumers.

Mr. Chairman, there has been some concern, and I understand there will be testimony later on from persons in the Virgin Islands, that this bill would harm the watch assembly industry in the Virgin Islands. This is patently untrue. The overwhelming majority of watches shipped from the Virgin Islands are mid- to high-priced watches. Based on market surveys, the average U.S. retail price for the five principal Virgin Islands brands was approximately $56 in 1984. This was more than twice the average of $26 paid for Timex watches. The duty savings for GSP for Timex watches is estimated to be 42 cents per watch.

Assuming full passthrough of the savings, the price effect at retail would be approximately $1 per watch. It is difficult to conceive that a change of $1 would change a consumer's choice of watch.

The second bill I would like to address is H.R. 2029, which would repeal the special marking requirements applicable to watches and clocks in schedule 7 of the tariff schedules. Watch and clock movements and watch cases must be marked with the country of origin and name of manufacturer or purchaser of the case or movement. Clock cases must be marked with country of manufacture, and watch and clock dials must be marked with country of origin of the dial. These requirements apply to finished watches and clocks. All these markings with the exception of the country of manufacture are made inside the watch and clock and therefore are not visible to the consumer.

These requirements were first enacted in 1909 when foreign-made watches were competing with U.S.-made watches and were designed to give protection to U.S. companies manufacturing and assembling watches in the United States. As I indicated previously, there is no longer a watch-assembly industry in this country. Only Timex has significant U.S. manufacturing operations. With virtually all watches and clocks sold in the United States assembled abroad, all we are doing is imposing an unnecessary cost that is passed on to consumers. Repealing these requirements would not, however, leave the consumer unprotected. The consumer would continue to be protected by three statutes that would still be in force. Section 304 of the Tariff Act of 1930 requires that all imported products be legibly marked on the outside with the country of origin. Section 5 of the Federal Trade Commission Act prohibits the sale of watches and clocks without an indication of their country of origin. And, section 43 of the Lanham Act prohibits the importation of watches and clocks that carry a false designation of the country of origin. These three provisions would continue to protect the consumer from counterfeiting.

Mr. Chairman, I believe the passage of these two bills would both protect American jobs and lower prices for American consumers and I hope you would report them out of the subcommittee favorably. I appreciate you letting me testify today.

Mr. Chairman, with your permission—later on in the day there will be testimony taken on H.R. 2354. With your permission, I would like to submit testimony for the record inasmuch as I do not believe I will be able to be here personally.

Chairman GIBBONS. Go right ahead.

Mr. ANTHONY. I would submit it for the record.

Chairman GIBBONS. Are you for it or against it?

Mr. ANTHONY. I am for it. It is a bill Mr. Duncan and I introduced. It is probably controversial in some parts of the country, but for all of the reasons stated in my expert testimony, I think you ought to report it out favorably also.

Chairman GIBBONS. Questions of Mr. Anthony?

Mr. FRENZEL. Mr. Anthony, the administration, as you know, did not have a position. I assume that means that you are still discussing the matter with the administration, and it would be the subcommittee's hope you can work out something that will get their approval.

Are you still working with them on it?

Mr. ANTHONY. Yes, Mr. Frenzel, not only working with the administration, but also working with representatives of the Virgin Islands and also—this would be one of those unusual circumstances where there is a competing watch company that happens to be located in Illinois, some say very close to the chairman's home town of Chicago, not that that may create a problem. But we have tried to talk to that watch manufacturing company to accommodate them so that we could reach a fair and equitable agreement.

Mr. FRENZEL. Sounds to me there are differences which would enable all parties to be taken care of.

Mr. ANTHONY. Yes. I think there is room to compromise so that competing watch manufacturers are not unduly harmed. Personally, I think H.R. 2028 would accomplish this. It will not harm the other watch manufacturer, yet it would give Timex some benefits, and that is the reason this subcommittee should resolve any differences in the event the parties themselves are not able to make the accommodations.

Mr. **Frenzel**. Thank you.

Mr. **Crane**. I would like to ask you a question, Beryl. I am fundamentally sympathetic with the proposal that you have legislatively before us. Does it require legislation to accomplish the objective? Is this something where a solution could be negotiated?

Mr. **Anthony**. Mr. Crane, I think at this point it would probably take this piece of legislation to move forward.

We have—I worked practically all of 1985 with the interested parties in trying to make necessary accommodations, and unfortunately it has just gotten now to the point where there are two firmly held viewpoints that are irreconcilable at the moment.

That is the reason I came forward to testify to ask this subcommittee to take a look at my testimony and my findings and then take a look at the testimony of other representatives of the watch industry, and then you use your judgment as to which facts seem to bear the greatest weight.

No one can argue with the fact that the watch industry has disappeared from the United States. This particular watch industry is not in my district. It is located in North Rock where there are very large employers, but inasmuch as it does have an impact on the employment in my State, and I happened to serve on the Ways and Means Committee, I felt it was my responsibility to come forward and try to work toward a compromise bill.

We have tired. We will continue to try, but I would hope that this subcommittee could assist us in nudging it along a little bit.

Mr. **Crane**. Thank you.

Mr. **Pease**. Mr. Chairman.

Chairman **Gibbons**. Mr. Pease.

Mr. **Pease**. Mr. Chairman—Beryl, with regard to your first bill, you indicated giving GSP treatment would lower the cost by, you say, 42 cents per Timex?

Mr. **Anthony**. I think 42 cents.

Mr. **Pease**. Does Timex face competition at that low end of the price range from other foreign manufacturers who ship watches into the United States?

Mr. **Anthony**. Basically from the Far East.

Mr. Pease, that is one of the strong arguments that we are making; that this piece of legislation would not hurt the watch industry in the Virgin Islands because they are in the high end. Timex is in the low end. Timex is competing with the Far East, and this would put them in a better position to compete in the low end of the market with those watch manufacturers in the Far East.

Mr. **Pease**. If GSP is approved then presumably the watches that come in from other foreign manufacturers at the low end would also get the benefits of GSP. There are some times that Timex would not have any advantage from this change. Am I missing something?

Mr. **Anthony**. No. I think that is exactly true. They are still going to be under intense competitive pressure. They feel that they actually need this to be put on a fairer competitive playing field.

Mr. **Pease**. Why would passage of this bill improve the competitive situation for Timex? How would it do that?

Mr. **Anthony**. They feel it would give them some savings in their assembly, and therefore, they could pass those savings on through to the consumer, therefore they would be more competitive in the marketplace. You have got to understand that the low end of the watch market is operated on a very thin margin.

They are operating on some very, very thin margins, so although the number itself seems small compared to other numbers this committee is used to hearing in that particular industry, this becomes a very significant cost factor.

Mr. **Pease**. If GSP will allow Timex to reduce its costs by 42 cents per watch, would it not also be facing competition from watches made in the Far East that come in 42 cents cheaper?

Mr. **Anthony**. I think the answer to your question is yes. I was just handed by my staff a statement that says that most watches are from countries which would not each be eligible for GSP, that is the big three—Japan, Switzerland, and Hong Kong.

These dominate the market, and producers from the big three would not be eligible for GSP.

Mr. **Pease**. So there would be a marginal advantage to Timex.

Mr. **Anthony**. Yes.

Mr. **Pease**. Thank you.

Chairman **Gibbons**. Let's have Mr. Rowland up here first, then Ms. Kennelly, and then Mr. de Lugo.

STATEMENT OF HON. JOHN G. ROWLAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. **Rowland**. I appreciate the opportunity to testify today, and I would urge the members of the subcommittee to support H.R. 2028 and H.R. 2029, the bills my colleague, Mr. Anthony referred to. H.R. 2028 would make watches eligible for GSP treatment and enable Timex Corp. and its many customers and suppliers in my district to compete more effectively with Japanese and other Far East competitors. H.R. 2029 will reduce costs to the consumer by eliminating certain markings on the inside of a watch.

Timex Corp. and many of its suppliers have been located in my district in Connecticut for nearly 30 years. I have witnessed in recent years the continuing erosion of Timex jobs in Connecticut from approximately 2,700 employees in 1977 to fewer than 800 today. Connecticut suppliers to Timex employ another 1,400 workers, but have also suffered at the hands of foreign watch companies using foreign suppliers. This painful loss of jobs has been a result of the tremendous influx of low-cost watches from Japan, Hong Kong, and other Far East producers. The entire U.S. watch industry has found it necessary to move operations offshore in recent years in order to survive. Skilled manufacture of watch components, research and development, engineering, product planning, styling, and other essential technology, however, continue to be located in Waterbury, CT, which has long been known for its watchmaking.

H.R. 2028 would enable Timex to halt the erosion of jobs and perhaps even increase its employment in Connecticut and the United States. This is because Timex watches assembled in GSP countries contain a high percentage of U.S. content.

GSP treatment would benefit not only the many working people in my district, but the millions of U.S. consumers, particularly middle- and working-class families, who have been and will continue to be able to buy a reliable watch at an affordable price.

In short, passage of GSP legislation would promote trade, benefit U.S. consumers, and help to keep watch technology and jobs in the United States. I thank you for this opportunity to appear before you today, and urge you to act favorably on these bills which are particularly important to my district.

Chairman GIBBONS. Mrs. Kennelly.

STATEMENT OF HON. BARBARA B. KENNELLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mrs. KENNELLY. Thank you for giving me the opportunity to appear before your committee on these two bills. As a Representative from the State of Connecticut, I join with Mr. Rowland in his desire to keep Timex in Waterbury, and also with Mr. Beryl Anthony, my colleague on the Ways and Means Committee.

Timex and many of its suppliers have been principally located in Connecticut and Arkansas for nearly 30 years. I believe these two bills, H.R. 2028 and H.R. 2029, will see they stay in these States and continue to flourish. While the U.S. watch industry was considered to be import sensitive in 1974, when watches were excluded from the GSP eligibility, today only Timex continues to manufacture parts and components in the United States, together with essential research and development, advanced technology, engineering, and other skilled manufacturing activities. I am here today to support these two bills, because by enabling Timex to cut its nonlabor costs, GSP for watches would enhance its competitiveness, and preserve and possibly expand its employment base in the United States.

In sum, I would like to just say that GSP treatment would encourage free trade and at the same time help to keep technology and jobs in the United States. For these reasons, I urge members of the subcommittee to support H.R. 2028 and H.R. 2029.

Thank you very much.

Chairman GIBBONS. I want to say a word in behalf of Timex. All through my college career, pre-World War II, I got by with a $1 Timex pocket watch. It kept perfect time. I finally added a stop watch to it, and later during the war I found I could time the mortar shell flight by my Timex watch.

Mr. DE LUGO. You are almost a legend in Bangkok. I was over there recently and the Ambassador was raving about the great job you did in diffusing the situation in the upset.

Chairman GIBBONS. We had a very fine distinguished congressional delegation.

Mr. DE LUGO. You stepped out into a crowd there and really won them over.

STATEMENT OF HON. RON de LUGO, A DELEGATE IN CONGRESS FROM THE VIRGIN ISLANDS

Mr. DE LUGO. Mr. Chairman, today I would like to just bring to the subcommittee's attention my concerns regarding H.R. 2028, which would grant GSP treatment of watches, and thereby would actually destroy the Virgin Island watch industry.

I ask that my written statement, which includes comments in support of H.R. 2225, be entered into the record along with my separate statement in opposition to the ethanol legislation.

Chairman GIBBONS. Do you want to appear later on the ethanol question?

Mr. DE LUGO. No, I will just put it in now.

Chairman GIBBONS. Very well.

Mr. DE LUGO. Mr. Chairman, gentlemen of the committee, I want to remind you it was this committee that helped us back in 1982. Back in 1982 the watch industry in the Virgin Islands was dying. It was down to just a handful of employees, and Congress passed legislation. Public Law 97-446, to revitalize the Virgin Islands watch industry, which had gone into a decline as a result of the change in demand from jewel to quartz watches.

Now, the quartz watches have few, if any, jewels, and thus are subject to low duties. The headnote 3(a) duty-free entry incentive was not sufficient to offset production of watches in locations which could offer wages of one-fifth the U.S. minimum wage. Timex is one of the companies that decided to terminate its Virgin Islands watch production for this reason.

To restore the industry's competitiveness, Public Law 97-446 eliminated the foreign content requirement and through the production incentive certificate introduced parity in the cost of watch assembly in the territories. Without the latter, the watch industry in the Virgin Islands would not survive.

If watches can enter duty free under GSP, then once more the incentive for operating in the Virgin Islands would be removed.

While the Virgin Islands is not under the 35-percent value added required under GSP, it is important to note that the labor requirements for the Virgin Islands are clearly enforceable by the United States. The 35-percent value-added criterion would be more stringent if it were being enforced directly by U.S. authorities. It is not, of course, but depends on certification by foreign, self-interested, governments. Consequently, the headnote 3(a) requirements are in fact more demanding than the GSP test.

Timex claims that Virgin Islands watches are not competitive with watches from LDC countries which retail at an average of $15 and Timex watches retailing at an average of $25, because watches assembled in the Virgin Islands retail at an average of $60 per watch.

But the range of watch prices in the Virgin Islands is $14 to $150. In its comments to the committee, Timex, Inc., significantly discusses only its average retail price, not its pricing range. A substantial number of Timex watches retail in the $25 to $60 range, the same retail area as the U.S. Virgin Islands watches. Thus, duty-free GSP watches would directly compete with the Virgin Islands industry, if Timex's request is granted.

We have now 400 people employed as a result of this. In any event, consumer tastes in the watch market are quite fluid, and there can be no doubt that the bottom of the line purchase, in a statistically significant portion of cases, is a permanent loss of purchases at the middle or high segment of the market.

Why is it important to protect the Virgin Islands watch industry? The Virgin Islands watch industry is the only remaining domestic watch industry. Furthermore, its survival is an important aspect of Federal policy to bolster the economies of its territories and to afford them an advantage, as parts of the American family, over foreign jurisdictions to which the United States is committed to lending a helping hand through programs such as GSP.

Also it is important to keep in mind a sense of scale. Sacrificing the Virgin Islands watch industry to the economic development of South Korea and Taiwan would be a blow to the small Virgin Islands economy comparable to the total loss of auto manufacturing to the national economy.

In conclusion, the advantages of the headnote 3(a) treatment of watches are meaningless unless Virgin Islands producers can sell their watches. If duty-free watches enter, the Virgin Islands will not be able to compete. By moving the question of eligibility for GSP treatment of watches into the administrative arena, the Virgin Islands watch industry would cease permanently and quickly. Quite literally, Virgin Islands producers would close up shop and start importing from Asia. Note the following:

First, Timex, the major proponent of this change, clearly expects to receive GSP treatment from one or more countries, despite the obvious impact on the domestic watch industry located in the Virgin Islands. Otherwise, why this effort?

Second, no one can guarantee the action of a future administration.

Third, merely making GSP eligibility a matter for administrative discretion would deal a fatal blow to the Virgin Islands watch industry. Investor confidence would be seriously shaken by knowledge that the industry can be destroyed by a single ruling.

I want to thank you very much, Mr. Chairman, gentlemen of the committee, for the opportunity to present my case.

[The prepared statement follows:]

Statement of Hon. Ron de Lugo, a Delegate In Congress From the Virgin Islands

Mr. Chairman, today I would just like to bring to the subcommittee's attention my concerns regarding two proposals: H.R. 2028, which would grant GSP treatment to watches, and thereby destroy the Virgin Islands watch industry; and H.R. 2225, which would provide the duty-free access for the few textiles entering the United States from its territories in the wake of the textile regulations issued in the fall of 1984.

WATCHES SHOULD REMAIN ON THE LIST OF ARTICLES INELIGIBLE FOR DUTY-FREE TREATMENT UNDER THE GENERALIZED SYSTEM OF PREFERENCES [GSP]

Timex, Inc., has argued that the Virgin Islands watch industry would not be harmed by GSP entry from lesser developed countries [LDC's] because Virgin Islands watches retail at prices higher than the sale price on watches entering from LDC's. This is not true. Watches from LDC's would compete within the price range of Virgin Islands watches, to the clear disadvantage of this domestic industry. Furthermore, the duty-free entry of watches under GSP would replace the share of the market held by Virgin Islands watch producers.

In 1983, Congress passed legislation which gave the Virgin Islands its only chance to resurrect its watch industry. Factors which supported the need for this special incentive include the desire to assure that Americans in the territories could participate in an industry that was otherwise located in the far east and the recognition that the Virgin Islands economy needs the help.

Most of the Virgin Islands watch companies are subsidiaries of United States firms. The Virgin Islands watch industry employs almost 500 persons, 26 percent of the local work force. Additionally, supporting jobs on the mainland, such as packaging, marketing, distribution and repair, flow directly from the Virgin Islands watch industry.

BACKGROUND

1. Back in 1982, Congress passed Legislation. Public Law 97-446, to revitalize the Virgin Islands watch industry which had gone into decline as a result of the change in demand from jewelled to quartz watches. The quartz watches have few, if any, jewels, and thus are subject to low duties. The headnote 3(a) duty-free entry incentive was not sufficient to offset production of watches in locations which could offer wages of one-fifth the United States minimum wage. Timex is one of the companies that decided to terminate its Virgin Islands watch production for this reason.

To restore the industry's competitiveness, Public Law 97-446 eliminated the foreign content requirement and through the production incentive certificate introduced parity in the cost of watch assembly in the territories. Without the latter, the watch industry in the Virgin Islands would not survive.

If watches can enter duty-free under GSP, then once more the incentive for operating in the Virgin Islands would be removed.

2. While the Virgin Islands is not under the 35 percent value added required under GSP, it is important to note that the labor requirements for the Virgin Islands are clearly enforceable by the United States.

The 35 percent value added criterion would be more stringent if it were being enforced directly by United States authorities. It is not, of course, but depends on certification by foreign (self interested) governments. Consequently, the headnote 3(a) requirements are in fact more demanding than the GSP test.

3. Timex claims that Virgin Islands watches are not competitive with watches from LDC countries which retail at an average of $15 and Timex watches retailing at an average of $25, because watches assembled in the Virgin Islands retail at an average of $60 per watch.

But the range of watch prices in the Virgin Islands is $14 to $150. In its comments to the committee, Timex, Inc., significantly, discusses only its average retail price, not its pricing range. A substantial number of Timex watches retail in the $25 to $60 range, the same retail area as Virgin Islands watches. Thus, duty-free GSP watches will directly compete with the Virgin Islands industry.

In any event, consumer tastes in the watch market are quite fluid, and there can be no doubt that the bottom of the line purchase, in a statistically significant portion of cases, is a permanent loss of purchases at the middle or high segment of the market.

4. Why is it important to protect the Virgin Islands watch industry? The Virgin Islands watch industry is the only remaining domestic watch industry. Furthermore, its survival is an important aspect of Federal policy to bolster the economies of its territories and to afford them an advantage, as parts of the American family, over foreign jurisdictions to which the United States is committed to lending a helping hand through programs such as GSP.

Also it is important to keep in mind a sense of scale. Sacrificing the Virgin Islands watch industry to the economic development of South Korea and Taiwan would be a blow to the small Virgin Islands economy comparable to the total loss of auto manufacturing to the national economy.

IN CONCLUSION

5. The advantages of the headnote 3(a) treatment of watches are meaningless unless Virgin Islands producers can sell their watches. If duty-free watches enter, the Virgin Islands will not be able to compete.

By moving the question of eligibility for GSP treatment of watches into the administrative arena, the Virgin Islands watch industry would cease permanently and quickly. Quite literally, Virgin Islands producers would close-up shop and start importing from Asia. Note the following:

(a) Timex, the major proponent of this change, clearly expects to receive GSP treatment from one or more countries, despite the obvious impact on the domestic watch industry located in the Virgin Islands. Otherwise, why this effort?

(b) No one can guarantee the action of a future administration.

(c) Merely making GSP eligibility a matter for administrative discretion would deal a fatal blow to the Virgin Islands watch industry. Investor confidence would be seriously shaken by knowledge that the industry can be destroyed by a single ruling.

H.R. 2225 WOULD PROVIDE DUTY-FREE TREATMENT INTENDED UNDER HEADNOTE 3(A) FOR TEXTILES ALREADY SUBJECT TO A STRICT QUOTA

Comments on H.R. 2225, published in WMCP 99-11, suggest that the bill is intended as a means of circumventing the strict rules of origin requirements for textiles laid out with great specificity in Treasury Decision 85-38. While I regret that administrative action has effectively gutted the special trade incentive for the territories as applied to textile products, it is important to appreciate that H.R. 2225 does not attempt to reverse this result. Instead, the bill would affect only the rate of duty, and clarify that the textiles could be marked as products of the U.S. territory.

When T.D. 85-38 was published, Guam and the Commonwealth of the Northern Marianas Islands sought relief. Neither of these jurisdictions could accommodate the loss of their textile industries. Guam managed to negotiate a quota with the administration which exempted it from the country of origin requirements for up to 160,000 dozen sweaters per year. Similarly, the Northern Marianas was granted a 70,000 dozen quota.

As expected, Treasury, on August 2, 1985, issued a change of practice denying duty-free benefits to the items covered by the textile regulations, including those items entering under the Guam and Northern Marianas quotas. This was the problem that H.R. 2225 anticipated.

What the committee must decide is not, as has been suggested, whether the strict rules of origin imposed by the textile regulations are being circumvented, but whether the products entering under the narrow textile quotas granted to two U.S. insular areas will benefit from the duty-free access heretofore available under headnote 3(a).

Business in the other territories which benefit from headnote 3(a) are watching closely. There is a growing perception that the country's commitment to economic development in its territories and commonwealths is waning. Tax and trade incentives, much tauted by the Federal Government as the basis for achieving economic self-sufficiency, are being eroded. Meanwhile, business is growing less confidant that benefits that offset the high cost of operating in offshore United States jurisdictions are sufficiently stable to justify investment.

Chairman GIBBONS. Thank you.

You know, we have a unique opportunity here. I don't want all of you to gang up on Ron down there, but you have heard his testimony, and would you like to respond briefly to it, and perhaps you would like to respond—he would like to respond to your response.

Mr. ANTHONY. With your permission, Mr. Chairman, I would have two or three rebuttal comments that I think would be of interest to the committee.

When Mr. de Lugo talks about price range rather than where the sales are, it is a valid point, but valid points sometimes can be, again, as lawyers know, be accepted out of a general rule. I would like to try to accept that out of the general rule.

In 1984, 83.8 percent of all Timex sales were at prices below $35. So although there is a price range that may go to $150 still 83 percent, $35 and below, while only 11.3 percent of Virgin Islands sales in the U.S. market were made at that range. These are market surveys, and they are irrefutable.

The bulk of Virgin Islands sales, on the other hand, some 65.3 percent, were in the $35 to $59 range, as contrasted to only 14 percent of the Timex sales made at that price. So there is in the marketplace a difference of competition in the prices of a watch. I think that is irrefutable.

Chairman GIBBONS. Some overlap but——

Mr. ANTHONY. There is some percentage of overlapping, but I think the market surveys will show it is not that significant although it is there. It is obvious that any watch manufacturer wants to try to offer watches in all ranges so that they can attract customers, although Timex has basically worked at the low end of the market.

I think another factor is very important for the committee. Market research has indicated that small price changes, and this goes into what Mr. Pease was questioning me about, at retail, less than $5 do not result in consumer switching purchases between brands. In other words, a dollar change in a watch between brands will not take away a customer, but if it gets $5 and above, then, it would have an affect.

Customers are likely to change brands, but as my testimony indicated, if you do allow GSP treatment, the actual difference in price will be no more than a dollar. I think these are important rebuttals to testimony that Mr. de Lugo has made. I do not dispute his testimony, I just think you can analyze it in a different light.

Mr. ROWLAND. Mr. Chairman, I would like to follow up on a question Mr. Pease had with regard to GSP treatment. I think it is important to note the President, through his U.S. Trade Representative, still has the final decisionmaking process to determine what countries would get GSP treatment.

So even if this bill does pass, the President indeed has the final decision. Also with regard to the Virgin Island watch industry, there are two benefits that they have under U.S. law. No. 1, the production labor incentives allow reimbursement of up to 90 percent of Virgin Island labor costs. This reimbursement reduces labor costs to a level far below that of its two major Far East competitors, Japan and Hong Kong and far below its major competitor, Switzerland.

Therefore, the Virgin Island watches enter the U.S. duty-free. Timex watches—and I am sure this can be rebutted—estimates the Virgin Islands watch industry costs the United States $10,000 per worker. So I think, Mr. Chairman, your comments about buying a Timex watch for a dollar indicates the low range of Timex watches.

I can't imagine there has been that much of a change in marketing from the dollar watch that you bought to a high level watch. Indeed, they do go for the lower market, and we contend there is no competition with the Virgin Islands in this marketplace.

Chairman GIBBONS. Barbara.

Mrs. KENNELLY. Mr. Chairman, I just would like to add that I have worked very closely with Mr. de Lugo on a number of issues with this committee, but I just have to respectfully disagree at this particular time. GSP treatment for watches makes a great deal of sense. I think that is substantiated in our testimony, and I would urge you to look with favor on these two bills.

Chairman GIBBONS. All right. Mr. de Lugo?

Mr. DE LUGO. Thank you very much.

First, let me say the Virgin Islands is not competing with the watch casing industry here on the mainland. It is only benefiting and asks to continue to benefit from the preference received. The Virgin Islands watch industry represents the only remaining U.S. assembly operations—they are the only ones under the American flag at the present time, and that is because of the action in 1982 of this committee.

Second, let me say that while the wage incentive program represents a subsidy, that subsidy is drawn directly from duties, the very

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duties that would be forgiven under GSP. They take no more, in fact, take less from Federal revenues than GSP treatment would. And let me say that Timex states the savings achieved by them, if this bill is passed, and then passed through would not be sufficient to change consumer buying habits. Well, whether or not this is true in the Timex world, Mr. Chairman, it has no validity in the real world of watch marketing where $14 to $25 is a large difference to the mass merchandise buyer who will not give the consumer an option to buy the less competitive Virgin Islands products because, it the mass merchandise store, will not offer them.

We see them for sale all over and advertised in the newspapers every weekend. The prices compete. Let me say that at the present time, because of the action of this committee and the Congress, the U.S. Virgin Islands in 1985 produced, assembled under the U.S. flag, 2½ million watches. This would be lost.

Mr. PEASE. Mr. Chairman.

Chairman GIBBONS. Mr. Pease.

Mr. PEASE. I would like to ask a question. Did I understand from Mr. Rowland that the wages paid to watch assemblers in the Virgin Islands are subsidized wages?

Mr. ROWLAND. Yes, 90 percent, up to 90 percent.

Mr. PEASE. Who pays the 90 percent? Who pays the subsidy, in other words?

Mr. ROWLAND. The United States, labor subsidy through United States Treasury is my understanding.

Mr. PEASE. Could Mr. de Lugo comment on that?

Mr. DE LUGO. Certainly. The wage incentive was endorsed by this committee, and the U.S. worker in the Virgin Islands benefits from this wage. The incentive is paid through an offset against duties on watch imports.

Mr. PEASE. Could you tell us what program that is under?

Mr. DE LUGO. That would be under the watch incentive program, under Public Law 97-446.

Mr. PEASE. Does that apply exclusively to U.S. possessions?

Mr. DE LUGO. Yes, it does.

Mr. PEASE. That is.

Mr. DE LUGO. This is the public law you passed in 1982.

Chairman GIBBONS. Anyone else have questions?

Thank you all very much.

We now have representatives from the Timex Co., Mr. Marsching, and from Clinton Watch Co., Mr. Wein.

Let's have Mr. Marsching first.

STATEMENT OF RONALD MARSCHING, VICE CHAIRMAN, TIMEX CORP., ACCOMPANIED BY TED GATES, TRADE COUNSEL

Mr. MARSCHING. Thank you, Mr. Chairman.

Chairman GIBBONS. Do you have any more of those dollar watches left?

Mr. MARSCHING. We have a letter from Mark Twain asking for some more of them; that is the famous Ingersol watch. Unfortunately it is out of production.

I am Ronald Marsching, vice chairman of Timex. I am accompanied this morning by Ted Gates, a trade consultant to Timex.

We would like to thank the committee for this opportunity to express our views on H.R. 2028 and H.R. 2029.

Watches are one of the few products excluded by statute from GSP. This exclusion was enacted to protect the U.S. watch industry. Ironically, it is now working to its detriment.

There are three reasons why H.R. 2028 should be enacted. The first is it would benefit the U.S. watch industry and its employees. It would benefit the American consumers, and it would contribute to the economic development of less developed countries. It has one very unusual feature, and that is it preserves U.S. manufacturing jobs and at the same time liberalizes trade and benefits the U.S. consumers.

Timex is the only remaining watch company with extensive U.S. manufacturing, research and development and other key operations. We employ 1,400 American workers in these activities.

Like other U.S. companies, especially producers of consumer electronic goods, Timex is hard pressed to cut costs so as to compete with foreign competition. Just in recent years alone, the big three of the Japanese industry have all competed very heavily in the low and middle price range and together produce about 15 million watches a year. I refer to Seiko, Casio, and Citizen Watch Co.

The bill will enable Timex to cut costs without further reducing domestic employment and will help us meet foreign competition. This is because while our watches are assembled in GSP country, such as the Philippines, our other operations, which I just described, take place in the United States. Sixty percent of the cost of a Timex-made watch is U.S. content.

The main opposition to H.R. 2028 appears to come from two sources. The first are importers of Japanese, Swiss, and Hong Kong watches. The second are watch assemblers in the Virgin Islands. The Japanese and other importers oppose the bill because the watches they import are not produced in countries which could be eligible for GSP. The Virgin Islands watch assemblers have expressed concern that GSP for watches will harm the Virgin Islands companies and employees. For reasons stated, in our written submission, we do not believe there will be harm to the Virgin Islands watch industry. The Virgin Islands watch assemblers have not explained why they believe they will be harmed.

Nevertheless, let me try to address their concern. In 1984, the United States imported 150 million watches and watch movements, less than 2 million, or 1.2 percent were from the Virgin Islands. Watch imports today are of every type and at all price levels.

What harm can GSP cause the Virgin Islands? Will it change the composition of watch imports in a way that significantly affects the Virgin Islands? No. The Virgin Island's principal product is quartz analogue watches. At least 82 percent of quartz analogue imports come from Japan, Switzerland, and Hong Kong. It is these imports which are the principal competition of the Virgin Islands. These imports will not be eligible for GSP.

Despite this competition, the Virgin Islands quota permitting duty-free shipment to the United States has been increased by one-third since 1983. More significantly, the Commerce and Interior Departments expect 1986 shipments to the United States from the Virgin Islands to be twice those of 1983. The Virgin Islands industry is competitive and growing. Its workforce is increasing. Aided by a variety of U.S. and local public benefits, it apparently is also very profitable.

Can the alleged harm be that GSP will reduce the costs of other importers so deeply that the Virgin Islands cannot compete with them? The answer is no for at least three reasons. First, the major competition at all price levels will continue to come from countries that will not qualify for GSP.

Second, potential duty savings from GSP countries will be so small so that at best they could have only a marginal effect. GSP savings to Timex, for example, would be approximately 42 cents. That cost change would not significantly affect consumer choices.

Third, existing and continuing United States and Virgin Islands governmental benefits to Virgin Islands watch assemblers provide extraordinary shelter from minor changes in competitive conditions. They include, in addition to duty-free entry into this market, production incentive certificates which provide a duty rebate of up to 90 percent of the wages paid in the Virgin Islands for watch assembly, 15-year, 90-percent income tax exemption, and 15 years, 100-percent property tax gross receipts and excise tax exemptions.

Moreover, there is a 50-percent subsidy for job training salaries and for the full cost of classroom training. There are other incentives. We estimate the U.S. benefits alone are $10,000 per job created or more than the average annual wages paid.

We are certain for the reasons given that GSP eligibility for watches will not harm the Virgin Islands. Furthermore, so strong is our conviction that there will be no harm to the Virgin Islands and so impressed are we with the incentives offered assemblers of watches in the Virgin Islands, we are, ourselves, seriously considering establishing a watch facility in the Virgin Islands that would add a significant number of new jobs, and this would apply whether or not the GSP is enacted.

I might say we have had a team down in the Virgin Islands, and they have talked to the local manufacturers, and Virgin Islands governmental officials, and they are tremendously impressed.

Reference was made earlier to Timex leaving the Virgin Islands. We would suggest the following: Timex left, for reasons including our phasing out of the high duty 17-jewel watch. Furthermore, the production incentive program had not yet been enacted. But it is an entirely different picture today. Making watches eligible for GSP will assist in keeping prices low to the U.S. consumer, aid developing countries in accordance with U.S. policy, and make it possible for the surviving watch industry to continue with U.S. watch operations and maintain its 1,400 U.S. jobs.

Chairman **Gibbons**. Thank you, sir.

Mr. **Marsching**. One remark.

Chairman **Gibbons**. Go ahead.

Mr. **Marsching**. I want to emphasize a point that has already been made. All H.R. 2028 would do is make watches eligible to be considered for GSP. As you know, granting GSP benefits is only decided after a thorough administrative process during which any questions of industry harm will be reviewed in detail by the ITC, STR and others.

I must mention that we also support the other bill on eliminating special watch marking requirements which are inside the watch and not legible to the consumer and obsolete today. I would like to thank the committee.

[The prepared statement follows:]

TOPICAL OUTLINE OF STATEMENT AND RECOMMENDATIONS

Ronald Marsching
Vice Chairman
Timex Corporation
Waterbury, Connecticut 06720
(203) 573-6838

Background

Timex Corporation is the last remaining American watch company designing, developing and manufacturing watches with a high level of U.S. content and U.S. technology. By making watches eligible for GSP benefits, H.R. 2028 will help Timex compete against foreign producers and thereby continue its U.S. manufacturing operations.

H.R. 2028--GSP FOR WATCHES

1. Reasons for H.R. 2028

A. Domestic Industry. GSP for watches will help what remains of the domestic watchmaking industry compete against foreign competition.

B. U.S. Consumers. GSP for watches will benefit low and middle income consumers since watches produced in GSP countries supply the low end of the U.S. watch market.

C. Developing Countries. GSP for watches will help the economic development of countries important to the U.S., such as the Philippines.

D. Caribbean Basin. GSP for watches will be consistent with CBI which does not make watches ineligible.

II. Response to Arguments Against H.R. 2028

A. Virgin Islands. GSP for watches will not harm the V.I. since (i) the vast majority of watches are imported from countries which would not be eligible for GSP, (ii) most V.I. watches do not compete with Timex or other lower priced watches produced in GSP countries, (iii) the maximum retail price change, assuming full pass through of the duty savings, would not be sufficient to affect the consumer's choice of a watch, (iv) the V.I. watch industry is healthy and growing, (v) the GSP statute contains procedural safeguards to protect the V.I. industry if there is any question of harm, (vi) current V.I. benefits are sufficient to protect the V.I. (estimate at approximately $10,000 per V.I. worker), and (vii) any additional competition to the V.I. would not be material in view of the already intense competition in the U.S. watch market. In 1984, 150 million watches and watch movements of every type and price were imported; less than 2 million or (1-1/2%) were from the V.I.

H.R. 2029--ELIMINATION OF SPECIAL WATCH MARKING REQUIREMENTS

The special watch marking requirements impose a needless burden on the watch industry and consumers for the following reasons:

1. The domestic watch industry which the special watch marking requirements were designed to protect does not exist, except for Timex.

2. The consumer does not require the marking requirements since they are found, with one exception, on the inside of a watch.

3. U.S. consumers bear the cost of complying with these unnecessary requirements.

4. The special marking requirements are unnecessary to protect the consumer against counterfeiting since other laws provide this protection. These laws are Section 304 of the Tariff Act of 1930, Section 5 of the Federal Trade Commission Act and Section 43 of the Lanham Act. The country of origin of a watch would still be required to be marked on the outside of watches.

5. The requirements impose an unnecessary burden on the U.S. Customs Service.

6. The requirements are already inapplicable to sold state (digital) watches and clocks which constitute 70% of all watches and clocks.

RECOMMENDATIONS

Approve H.R. 2028 and H.R. 2029.

STATEMENT

Mr. Chairman and Members of the Committee, my name is Ronald Marsching, Vice Chairman of Timex Corporation. I welcome the opportunity to testify in support of H.R. 2028, a bill which would make watches eligible for duty-free entry into the United States under the Generalized System of Preferences and H.R. 2029, to repeal special marking requirements for watches and clocks.

H.R. 2028 promotes the purpose of GSP by providing significant aid to developing countries. At the same time it assists the domestic watch-making industry in competition with foreign producers. This bill may be unique because it preserves U.S. manufacturing jobs, while at the same time liberalizes trade and benefits U.S. consumers.

BACKGROUND

Competition in the watch business has for many years been intense. After World War II the market was dominated by the Swiss watch industry, but U.S. companies, such as Timex, broke this domination by applying mass production techniques and lowering costs to the point where every American could afford a watch.

As consumer products have changed from mechanical to electronic solid state technology, whole sectors of the U.S. consumer product market have come to be dominated by the industries of other countries, such as Japan and other Far Eastern countries.

Like many other domestic manufacturers, Timex recognized it could not compete effectively if it continued the labor intensive assembly phase of watchmaking in the U.S. Accordingly, Timex was forced to move its watch assembly operations to the Philippines and other low cost locations.

Timex, however, did not move its manufacture of watch cases and other watch parts or its research and development activities to the Far East. Timex watches assembled in the Philippines contain parts manufactured in its Connecticut and Arkansas facilities. These U.S. operations are highly skilled and capital intensive activities. Timex is the only company left in the U.S. designing, developing and manufacturing watches and related products with a high level of U.S. content and U.S. technology. It also is the only significant watch manufacturing company with management based in the U.S.

Under the Trade Act of 1974, Congress authorized the granting of preferential duty-free treatment for developing countries through the Generalized System of Preferences (GSP), but it excluded certain products from the program. Watches were among the excluded products, reflecting Congress' concern at that time that GSP treatment might prove injurious to the domestic watch industry.

Today, the situation is reversed. The domestic watch assembly industry no longer exists and Timex is the last significant watch company left in the U.S. For example, in 1982 Bulova signed an agreement with a Swiss company which ended Bulova's long history as a manufacturer of its own movements. We understand Bulova terminated its U.S. watch production activities during 1984.

This bill is important to Timex and its Connecticut and Arkansas workers. If watches are made GSP eligible, allowing Timex to reduce costs, Timex domestic operations will be able to more successfully compete against the foreign competition which now dominates the U.S. watch market, and hopefully be able to expand its U.S. base.

Timex also supports H.R. 2029, a bill to eliminate the special internal watch marking requirements for watches imported into the U.S. These requirements impose a needless burden on the U.S. watch industry and the U.S. Customs service, and are of no use to consumers since they appear inside the watch.

I will now discuss in greater detail the reasons why these bills should become law.

H.R. 2028--GSP FOR WATCHES

I. REASONS FOR H.R. 2028

A. Effect on Domestic Industry. First, GSP for watches would aid what remains of the domestic watch-making industry. As noted above, Timex is the last significant U.S. watch producer. We employ skilled workers in production of watch parts, case-making, case-plating, design, engineering, research and development, management, and service and repair in our Connecticut and Arkansas facilities.

By enabling Timex to reduce costs, GSP for watches will help Timex and its U.S. suppliers compete against Japanese and other Far Eastern watch manufacturers and thereby help retard, and hopefully arrest, further reductions in Timex' U.S. employment. GSP would bolster Timex' competitiveness since its watches are assembled in GSP eligible countries.

The duty savings would also allow Timex to increase its expenditures for research, engineering and technology. Timex has relationships with well-known U.S. companies for development of new technology for watch and watch related products. In addition, many U.S. suppliers will benefit from the preservation of U.S. watch manufacturing as a result of GSP treatment. Timex currently purchases millions of dollars in raw materials, components, and operating supplies annually from other U.S. producers.

Timex has been able over the years to remain competitive and keep consumer prices low by constantly reducing its costs of production. As foreign competition has intensified, Timex has been forced to move assembly operations to lower cost areas. There are, however, countervailing considerations which point to the continuation of operations in the United States. For these reasons, Timex prefers to maintain the remaining operations in the United States. However, if it is unable to achieve additional cost reductions in other ways, through the proposed GSP bill, given the competitive pressures from foreign companies it will have to consider moving further operations overseas.

B. U.S. Consumers. Second, watches produced in GSP beneficiary countries supply the low end of the U.S. watch market, and duty savings realized through GSP treatment will be of most benefit to low and middle income consumers. Most watches in the middle and high end of the U.S. market are imported from countries which would not be eligible for GSP, such as Japan and Switzerland.

C. Developing Countries. Third, granting GSP treatment to watches would help support the economic development of beneficiary countries most in need of such assistance. Watch assembly is particularly well-suited to developing countries. The assembly of watches is labor-intensive and can be performed with modest capital investment.

Timex employs about 3,000 workers in its watch assembly facility in Cebu, Philippines, a GSP eligible country. These workers are responsible for the support of over 12,000 Philippinos in a country which is considered important to the U.S. Cebu has an unemployment rate approaching 50 percent. The workers, who receive training to develop their technical skills, assemble Timex parts into watches. These watches are then shipped to Timex' Torrington, Connecticut facility where they are fitted with straps and bands, boxed and prepared for distribution to customers.

D. Caribbean Basin. To render watches eligible for GSP treatment would be consistent with treatment of watches in the Caribbean Basin Economic Recovery Act of 1983. Section 213 of that Act (19 U.S.C. 2703) does not include watches on the list of ineligible articles, except watches that contain any material that is the product of a Communist country. Moreover, watches were not given special consideration in the recent free-trade arrangements reached with Israel.

II. Response to Arguments Against H.R. 2028

Some opponents of the bill are importers of foreign watches. They oppose it because the watches they import are not produced in countries which could be eligible for GSP. Some companies which assemble watches in the U.S. Virgin Islands (V.I.) also are opposed to the bill on the ground it would harm their operations. After a detailed examination of their arguments and an on-site investigation in the V.I., Timex disagrees. In fact, we find that the benefits and incentives provided by the Congress for V.I. assemblers have resulted in a highly competitive industry. Timex will be deciding in the next few months whether it will itself set up a V.I. watch facility.

A. Virgin Islands. Timex has several points to make in response to the argument that GSP for watches will harm the Virgin Islands' watch assembly industry. In contrast, no detailed explanation of why there will be harm has been heard from the V.I. assemblers -- only unsupported conclusions.

1. Most watches are imported from countries which would not be eligible for GSP. The principal competition for the V.I. is producers from Japan, Switzerland and Hong Kong, who together account for 85% of all watches imported into the U.S. V.I. assembled watches account for less than 1 1/2% of U.S. watch

imports. These dominant producers would not be eligible for GSP. Japan and Switzerland are industrialized countries and not GSP eligible. The obvious competitiveness of Hong Kong should disqualify it from GSP for watches.

2. Most V.I. watches do not compete with Timex or other lower priced watches. Based on market research, the average retail price of V.I. assembled watches is $56 as compared to an average retail price of $26 for Timex watches. The figures are averages of prices consumers reported paying in 1984 and 1985 through November, and take into account the number of watches sold in each price bracket. Not only do the preponderance of Timex sales not compete with V.I. sales, but the principal competition of the V.I. assemblers in their price ranges is Japan and Swiss producers, who would not be eligible for GSP.

Although there is some price overlap between Timex sales and V.I. sales, price is not the only basis of competition. Watch producers develop and seek to maintain strong brand images to attract consumers. They seek to retain their customers on the basis of experience with quality, service, reliability and brand name recognition. Watch customers also are strongly attracted to jewelry features and styling. Some customers perceive internal jewels as adding value and performance. Promotional activities strongly determine other purchasing decisions.

A review of the style and price offerings of V.I. watch assemblers in the U.S. market reveals that most of their watches emphasize style elements such as gold metal bands, gold cases, refined dials and precious stones. Style elements such as these do not appeal to the propoundance of Timex consumers.

For all these reasons, Timex and other low priced watches do not substantially compete against V.I. assembled watches. In short, when consideration is given both to the maximum possible amount of price change from GSP (see below) and to the importance of non-price factors in watch purchases, it is clear the V.I. assemblers will not be affected by GSP availability. The established, brand-name V.I. assemblers have traditional channels to the U.S. market in the medium and higher price ranges, largely through catalog sales and discount outlets.

3. The maximum price effect at retail of GSP availability would not be sufficiently large to cause any appreciable effect on the V.I. The duty savings from GSP for Timex watches is estimated to be 42 cents per watch. Assuming full pass through at this savings (with traditional mark ups by distributors and retailers), the price effect at retail would be approximately $1.00 per watch. This is a nominal price change, and based upon Timex's experience, is not sufficient to change a consumer's choice of a watch.

4. The V.I. watch industry is healthy and growing. In the first nine months of 1985, for example, watch imports from the V.I. in dollar and unit terms have increased 35% and 27%, respectively over the comparable period in 1984. Earlier this year, the Departments of Commerce and Interior forecast 1986 shipments of all watches and movements from the V.I. assemblers would be twice as large as 1983.

5. The GSP statute contains procedural safeguards to protect the Virgin Islands industry if there should be any question of harm. All H.R. 2028 would do is make watches eligible for GSP. The statute prescribes an intensive investigation and review, including referral to the International Trade Commission for advice on probable economic effect, public hearings, and a determination of any import sensitivity by expert agencies before the President can authorize duty-free treatment. Whether or not GSP for watches would harm a domestic industry should be determined by these expert agencies in the established administrative process. We emphasize that GSP benefits can be revoke or withheld for numerous reasons. Such reasons include the "competitive need formula", the "graduation primcipal" and political consideration as protection of U.S. intellectual property right, and other condition. These limitations governing the GSP program make it unlikely a company would relocate facilities for GSP.

6. Current V.I. preferences are sufficient to protect the V.I. -- with or without GSP. The V.I. watch assemblers enjoy generous benefits, such as production incentives and duty-free entry of watches. Timex estimates that the cost to the U.S. Treasury of these benefits to the V.I. watch industry is approximately $10,000 per V.I. worker. Translated to per watch terms, Timex estimates the present preferential treatment for V.I. watches is in excess of $2 per watch ex-factory and approximately $6.00 at retail. In fact, Timex itself is considering setting up a V.I. facility and a final decision should be made in the next few months.

7. Any additional competition to V.I. producers from potentially eligible GSP countries would be insignificant in view of the already intense competition in U.S. watch market. Japan, Switzerland and Hong Kong account for 85% of U.S. imports. To the extent V.I. producers are not already adjuncts of Swiss and Japanese producers or assemblers of their components, V.I. watches compete with them for U.S. market share. Any possible additional competition from less developed GSP countries for the remaining U.S. market is likely to be insignificant compared to existing competition from Japan, Switzerland and Hong Kong.

In summary, while we understand V.I. assemblers would like to maintain every possible advantage, there is no basis for maintaining that the V.I. assembly companies would be significantly affected if watches became GSP eligible.

B. Remaining Arguments. The remaining arguments in opposition to H.R. 2028 are not valid. The American Watch Association (the "AWA"), for example, has claimed H.R. 2028 is discriminatory in its impact since Hong Kong, Taiwan and South Korea would be denied eligibility for GSP treatment, and the Philippines would be the only beneficiary of the legislation. But the bill by itself would not allow watches to enter the U.S. duty-free under GSP. Duty-free treatment would be afforded to those developing countries which satisfied a number of tests contained in the GSP statute. These tests are nondiscriminatory, and any developing country that meets these tests could import watches duty-free into the United States.

The AWA states that Hong Kong would almost certainly be denied GSP treatment because it has already shipped to the United States more than the statute allows under the "competitive need" test. That test applies to all developing countries under the GSP statute. It is designed to assure that once a developing country becomes internationally competitive with respect to a certain product that product will no longer benefit from GSP treatment. If Hong Kong is competitive, it should not be granted GSP. In the case of Taiwan and Korea, the AWA states these countries might not be given GSP treatment because they have allegedly failed to cooperate in seeking to halt the flow of counterfeit watches. If that is so, then Taiwan and Korea should properly be denied GSP treatment. Over 100 countries are eligible for GSP. If a few countries cannot avail themselves of GSP because they do not meet one or more of the nondiscriminatory criteria in the statute, this is not a reason for excluding watches from other less developed countries from GSP.

The AWA has also claimed that "developing countries" do not need GSP treatment for watches, since in 1984 83% of total imports of watches by quantity were shipped from Hong Kong, Taiwan, Singapore and the Philippines. The AWA does not mention, however, that the 83%, based on unit shipments into the U.S., is distorted by the huge volume of watches imported from Hong Kong (over 100 million units) which by itself, accounts for 72% in the 83% figure. Hong Kong is not expected to be eligible for GSP on watches because of its self-evident competitiveness.

In fact, Switzerland, Japan and Hong Kong overwhelmingly dominate the U.S. market and no more than 15% is left for developing countries. In the case of mechanical and quartz analog watches, in 1984, the following three countries shipped the indicated percentage (by value) of all imports in this category:

Japan	42%
Switzerland	22%
Hong Kong	21%
	85%

Thus, all other countries shipped only 15% in this category.

In the case of digital watches, in 1984, the following two countries shipped the indicated percentage (by value) of all imports in this category:

Hong Kong	59%
Japan	26%
	85%

Thus, all other countries again shipped only 15% in this category.

In short, the developing countries in the two residual groups, accounting for no more than 15% of imports according to Department of Commerce data, clearly need GSP treatment in order to try to compete with such giants as Hong Kong, Japan and Switzerland.

H.R. 2029--ELIMINATION OF SPECIAL WATCH MARKING REQUIREMENTS

A. Introduction and Summary. H.R. 2029, which would repeal the special marking requirements applicable to watches and clocks in schedule 7 of the Tariff Schedules of the United States, should be approved by the Subcommittee on Trade of the Committee on Ways and Means for the following reasons, which will be more fully discussed below:

1. The industry that the special marking requirements was designed to protect does not exist, since there is no longer a watch-assembly industry in this country.

2. The consumer would not be disadvantaged by the repeal of the special marking requirements. All the markings (with one exception) are inside the watch or clock.

3. The special marking requirements impose an unnecessary cost upon the U.S. consumer, since virtually all watches and clocks sold in this country are assembled abroad and must comply with the requirements upon importation.

4. The special marking requirements are unnecessary to protect the consumer against counterfeit watches. The consumer would continue to be protected by three statutes that would be unaffected by the repeal of the special marking requirements -- section 304 of the Tariff Act of 1930, section 5 of the Federal Trade Commission Act, and section 43 of the Lanham Act. The country of origin would still be required to be marked on the outside of watches.

5. The special marking requirements impose an unnecessary burden upon the U.S. Customs Service, since its limited resources must be used to ensure compliance with the requirements.

6. The special marking requirements are already inapplicable to solid state (digital) watches and clocks, which constitute about 70% of all imported watches and clocks. Digital watches and clocks are now classified under schedule 6 of the Tariff Schedules of the United States.

B. Summary of Special Marking Requirements. Unlike almost all other imports, watches and clocks, and parts thereof, are subject to special marking requirements. Those requirements are set forth in headnote 4 of subpart E of part 2 of schedule 7 of the Tariff Schedules of the United States (TSUS). Headnote 4 contains the following requirements:

(a) Watch and clock movements must be marked with:
  (i) country of origin of the movement
  (ii) name of manufacturer or purchaser of the movement
  (iii) number of jewels, and
  (iv) number of adjustments (watch movements only)

(b) Watch cases must be marked with:
  (i) country of orgin of the case, and
  (ii) name of manufacturer or purchaser of the case.

(c) Clock cases must be marked with country of manufacture.

(d) Watch and clock dials must be marked with country of origin of the dial.

These requirements apply to finished watches and clocks, as well as parts thereof. Consistent with headnote 4, all the markings (except the country of manufacture of the clock case) are made inside the watch and clock, and are not visible to the ultimate consumer.

C. Discussion. There are significant reasons why H.R. 2029 should be approved by the Subcommittee on Trade of the Committee on Ways and Means. These reasons demonstrate that H.R. 2029 would not harm any domestic industry, but would benefit the consumer and relieve the U.S. Customs Service (Customs) of an unnecessary burden.

1. The special marking requirements were designed to protect what is now a non-existent industry, except for Timex. The special marking requirements were first enacted in 1909 in paragraph 192 of the Tariff Act of 1909 (36 stat. (Part 1) 31 (1909-1910)). At that time, foreignmade watches and clocks were competing with U.S. made watches and clocks by a variety of unfair trade practices, including the mislabeling of the country of origin, the manufacturer, and the number of jewels. The special marking requirements were designed to give protection from such practices to U.S. companies manufacturing and assembling watches and clocks in the U.S. Today, only Timex has significant U.S. watch manufacturing operations.

2. The U.S. consumer would not be disadvantaged by the repeal of the special marking requirements. As already noted, all the markings (with one exception) required by the special marking requirements are placed inside the watch and clock. Indeed, as a matter of practice, they are never placed on the outside of the watch and clock. A consumer would have to open the watch or clock to see the special markings.

Repeal of the special marking requirements would therefore not disadvantage the consumer who is not aware of the special markings in any event. Timex believes, as the largest seller of watches in the U.S., that consumers have no interest in the information disclosed by the special markings. As noted below, section 304 of the Tariff Act of 1930 will continue to require the country of origin to be marked on the outside of a watch, the only marking we believe to be of interest to a consumer.

3. The consumer would continue to be protected by three statutes that ensure the authenticity of the watch or clock he buys. Repeal of the special marking requirements would not affect the anti-counterfeit provisions of the Tariff Act of 1930, the Federal Trade Commission Act, and the Lanham Act.

Section 304 of the Tariff Act of 1930, as amended (19 U.S.C. 1304), requires that all imported products, including watches and clocks, be legibly and conspicuously marked on the outside with the country of origin. In the case of watches, Customs considers the country of origin of the movement to be the country of origin of the watch. Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) has been consrued by the FTC to prohibit the sale of watches and clocks without an indication of their country of origin. Section 43 of the Lanham Act (15 U.S.C. 1125) prohibits the importation of watches and clocks that carry a false designation of the country of origin. Together, these three provisions ensure that the consumer is adequately protected from counterfeiting.

4. The special marking requirements impose an unnecessary cost upon the consumer. Virtually all watches and clocks sold in the U.S. are assembled abroad. All such foreign assembled watches and clocks must therefore comply with the special marking requirements. Such compliance entails an additional manufacturing cost which is passed on to U.S. consumers in the form of a higher selling price. This additional and needless cost would be eliminated by the repeal of the special marking requirements.

5. The special marking requirements impose an unnecessary burden upon the U.S. Customs Service. The special marking requirements demand that a certain amount of Customs' resources be devoted to ensuring compliance. Yet these requirements are no longer needed, have no purpose, and simply increase the cost of a watch or clock. Customs' resources are therefore needlessly spent when they might be devoted to a useful purpose.

Customs is already hard-pressed to cope with mounting imports that were valued at about $325 billion in 1984. It is constantly seeking ways to expedite the entry of goods, consistent with the protection of the revenue. The repeal of the special marking requirements would help achieve this goal.

6. The special marking requirements are already inapplicable to about 70% of imported watches and clocks. Until 1982, all watches and clocks were classified in schedule 7 of the TSUS and were therefore subject to the special marking requirements. In United States v. Texas Instruments, Inc., 69 CCPA (Customs) 136, 673 F.2d 1375 (1982), the U.S. Court of Customs and Patent Appeals held that solid state watches and clocks are classifiable under item 688.45 of schedule 6 of the TSUS as electrical articles and parts thereof not specially provided for.

In 1984, about 70% of all watches and clocks imported into the United States were digital. The special marking requirements therefore cover less than a third of all imports. Non-applicability of these requirements to digital watches and clocks has created no apparent problem, further illustrating that no useful purpose would be served by continuing these requirements for other clocks and watches.

For the foregoing reasons, Timex urges passage of H.R. 2029.

Conclusion

In closing, I would like to emphasize two points. Making watches eligible for GSP would protect American jobs, help keep prices low to the American consumer and aid developing countries consistent with the Generalized System of Preference. Finally, as to the special marking requirements, we believe these impose a needless burden on industry and government and are of no benefit to the consumer.

I thank you for the opportunity to appear today.

TIMEX CORPORATION

February 6, 1986

BY HAND

Honorable Sam Gibbons
U.S. House of Representatives
2204 Rayburn Building
Washington, D.C.

Dear Chairman Gibbons:

I want to inform the Committee that the Customs Service and Timex have developed an amendment to H.R. 2029 which would retain certain of the special marking requirements. Due to the emphasis at the hearing this morning on H.R. 2028, I was unable to mention this compromise.

Enclosed herewith is the proposal. It would retain the marking on the movement of the country of origin, and the marking on the case of the country of origin if the case is imported separately. Timex supports this compromise.

We want to express our appreciation to the Customs Service for its cooperation in developing this amendment.

Sincerely,

Ronald Marsching
Vice Chairman

Enclosure

cc: John Simpson, Director
Office of Regulations and Rulings

John Rehm, Esquire

EXHIBIT C

PROPOSED SUBSTITUTE FOR H.R. 2029

A BILL

To amend the Tariff Schedules of the United States in order to simplify the special marking requirements for imported watches and components of imported watches and clocks.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That headnote 4 to subpart E of part 2 of schedule 7 of the Tariff Schedules of the United States (19 U.S.C. 1202) is amended in its entirety to read as follows:

> "4. Special Marking Requirements: -- (a) No movement provided for in this subpart, whether imported separately or attached to an article provided for in this subpart, and no case provided for in this subpart, when imported separately, shall be permitted to be entered unless conspicuously and indelibly marked, by such permanent means as cutting, die-sinking, engraving, stamping, or mold-marking (either indented or raised), with the name of the country of which it is a product. Such marking of cases shall be on the inside the caseback or bezel.
>
> (b) In lieu of the requirements of section 304 of this Act, no watch provided for in item 715.05 shall be permitted to be entered unless conspicuously and indelibly marked on the outside of the caseback, by such permanent means as those described in paragraph (a) of this headnote, with the name of the country of which its movement is a product, unless the Secretary of the Treasury permits another means of marking. Such country designation shall be preceded by the word 'movement' or an abbreviation thereof approved by the Secretary of the Treasury."

Sec. 2. Headnote 5 to subpart E of part 2 of schedule 7 of such Schedules is amended by striking from the second sentence the words "and its dial".

Sec. 3. The amendments made by this Act shall apply with respect to articles entered on or after one year after the date of the enactment of this Act.

Chairman GIBBONS. Before we go to questions, we want to say we are happy to see Mr. Gates with you.

Mr. GATES. Keeping with your 5-minute limitation, I will not add anything.

Chairman GIBBONS. Now, Mr.—I want to pronounce your name correctly. Wein?

Mr. WEIN. It is Wein.

Chairman GIBBONS. Go ahead, Mr. Wein. We are happy to hear from you.

STATEMENT OF IRVING L. WEIN, PRESIDENT, CLINTON WATCH CO.

Mr. WEIN. Thank you, Mr. Chairman.

I do appreciate the opportunity for speaking to this committee. I did want to reemphasize the world we see rather than the world that has been presented to you by the Timex special teams that are here. What is particularly threatening to us and concerns us most seriously, those of us who assemble in the Virgin Islands, is the fact that Thailand, Singapore, and Taiwan are also GSP countries which would be eligible for duty-free entry of watch movements and watches under H.R. 2028. Thailand has an important watch assembly industry. It also has substantial watch case and watch dial capacity.

Singapore has a watch-assembly industry and, as a matter of fact, in Thailand the Swiss, I understand, are planning a major new watch-assembly facility there. Singapore also has watch-case manufacturing and watch-dial manufacturing capacity.

Taiwan has a very mature and sophisticated watch-case industry and watch-dial industry, and inasmuch as watch assembly is not a capital-intensive industry, they could very rapidly develop a watch-assembly industry in Taiwan and be in a position to export finished watches. The estimates given by Timex of the duty savings presumably include movement duty and case and bracelet duty or case duty of a very modestly priced watch, but if we were to add gold-plated cases and more expensive bracelets, we see duty-free entry which would give GSP exporting countries, including Thailand, Singapore, Taiwan, an advantage from $2 to $5. This is the threat we foresee if we open up this Pandora's box.

We are most concerned about it because surely it would end the watch assembly industry in the Virgin Islands. I would also like to question the statistics that have been given us at the hearing and elsewhere in written presentations concerning the competitive nature of the Timex product range with the Virgin Islands assembled watches. We heard today that 83 percent of Timex watches retail under $35. Even the statistics on importation from the Philippine Islands alone of over 6 million would mean that something over 1 million Timex watches retail from $35 or more or even $30 or more—the number is probably greater—and we haven't heard any absolute numbers from Timex as to how many watches they sell in this area.

I am sure the Philippines is not their only assembly point. Timex is an international corporation, the biggest in the business so far as we know, the richest, the most powerful, so much so in fact that they were able to spend millions of dollars on one television commercial for the Superbowl game, and here we are being asked for the U.S. Government to subsidize this corporation to the tune of $2.5 or $3 million a year from the Philippine Islands alone.

Simply as a competitor in the American market, we would feel that this is most unfair. They certainly don't need it. The threat to the Virgin Islands industry, I think, is absolute. If we opened up Taiwan, Thailand, Singapore, and other GSP countries for duty-free entry, the people who make watches will quickly move in to take advantage of the opportunity.

I am also opposed in its present form to H.R. 2029. There are certainly some revisions possible in current marking regulations, but I think if Timex is serious about this, they should do some consulting with the American Watch Assemblers Association, and see whether they can't come to a meeting of the minds. A lot of the markings required are very old requirements and presumably some are unnecessary; however, the current bill opens up an awful lot in the way of smuggling, counterfeiting, et cetera. I see the orange light is on. I am scared of that.

Chairman GIBBONS. Don't get scared by our modern electronics. You still have some time. Go ahead.

Mr. WEIN. I do want to thank Mr. de Lugo for bringing out the question of the average price area. If we have got 25 million watches being sold, over $25 and under $25, those 25 million that are over $25 are pretty serious in terms of competition. Perhaps the folks from Timex would tell us how many watches in exact numbers they sell from $30 and up. That would be a big help.

[The prepared statement follows:]

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The CLINTON Watch Company 1104 SOUTH WABASH AVE • CHICAGO ILLINOIS 60605 • CABLE CLINWATCH
TELEX NO 25-6114

STATEMENT
of
IRVING L. WEIN
President of Clinton Watch Company

Before the Subcommittee on Trade
Committee On Ways and Means
(Honorable Sam M. Gibbons, Chairman)
At the Hearing on February 6, 1986

Clinton Watch Company has been in the watch importation and assembly business since 1922. I, personally, and my company have been involved in Virgin Islands watch assembly for about 20 years. Ours is a small company with relatively little brand recognition and we believe that the viability of our company in today's market is almost completely conditioned on the continued existence of an economically sound Virgin Islands watch assembly industry. Our affiliate, Hampden Watch Company, in St. Croix, V.I., assembles movements for a very substantial percentage of the watches we market.

Congress has repeatedly over the years confirmed the interest of the United States in maximizing employment in the Virgin Islands and has passed legislation designed (with the cooperation of the V.I. Government) to make watch assembly economically viable and to minimize the unemployment in St. Croix which has hovered around the 10% level.

The Timex Corporation is pressing for the passage of H.R. 2028 which would make watches eligible for duty-free entry from GSP countries. It is our contention that the passage of this bill would, in fact, doom the Virgin Islands watch assembly industry within a very few years.

Timex has submitted a letter dated October 8 stating its position and has offered additional comments on Clinton's original objections to this bill.

In their responses they have made a number of statements which are clearly irrelevant, factually inaccurate, and in sum give a wholly distorted picture of the current watch market and the effect of H.R. 2028 if passed.

We are singling out a few of the most important areas of inacurracy and wish to comment as follows:

1) Timex states that the savings achieved by them if this bill is passed and then passed through, would not be significant enough to change consumer buying habits. Whether or not this is true in the Timex world, it has no validity in the real world of unbranded watch marketing. 15¢ to 25¢ is a large difference to the mass merchandise buyer who will not give the consumer an option to buy the products because the mass merchandise store will not offer them.

2) Timex's contention that most V.I. watches do not compete in the same price range as Timex is false and misleading, which they cannot help but realize. Timex offers a substantial number of models retailing from $25.00 to $60.00 -- exactly the same retail area as V.I. watch production.

3) Timex's statement that most watches are currently manufactured in countries which are not eligible for GSP is true. However, they conveniently ignore the fact that in Taiwan (eligible for GSP) a sophisticated watchcase, watch-band, and dial manufacturing industry exists. Watch movements assembled in Taiwan or elsewhere could be used in finished watch assembly that would easily meet the added value criteria of GSP and allow entry of low, middle, and high priced watches on a duty-free basis as to the movement,

watchcase, and watch-band. This combination could create a $2.50 to $5.00 advantage per unit in popular priced watches. The same situation exists in Singapore (GSP eligible) and could exist quickly in Thailand (GSP eligible).

Timex would have us believe that since there is no current significant watch exportation to the United States from GSP countries--that the very sophisticated, enterprising, aggressive, knowledgeable Hong Kong watch manufacturers would not leap at the opportunity for duty-free entry into the American market. In our opinion, this is a ridiculous and unrealistic position that no person with any knowledge of Asian marketing techniques could possibly believe.

4) Timex has emphasized the "enormous" benefits enjoyed by Virgin Islands watch producers. They have neglected to mention that for approximately 16 years (1966-1981) Timex had an assembly plant in the Virgin Islands employing up to 70 people and found the "enormous" benefits insufficient to justify their continued presence as a V.I. watch assembler.

As a matter of fact, in 1982 Timex wrote to this Committee stating that it had "carefully reviewed the provisions in H.R. 5758 and concluded the proposed new incentives would not justify resumption of operations in the insular possessions."

It is our position that Timex's concern with their own benefits under this bill have blinded them to the real and imminent danger. The passage of this bill would surely and quickly result in a flood of watches from GSP countries entering the United States duty-free. We believe that without any question this would destroy the Virgin Islands watch assembly industry and we urge your rejection of this bill.

Chairman **Gibbons**. All right. Let me ask both of you, in your opinion, is it possible to carve out a niche, by either value or some other method, in this bill to minimize the impact on the Virgin Islands? Either one of you can take a crack at that one.

Mr. **Marsching**. As we have said, we don't believe the bill would harm the Virgin Islands; however, we have been asked whether we would agree to a value bracket compromise by which watches entering the United States above a certain value would not be eligible for U.S. treatment. This would mean watches from developing countries competing with Virgin Islands watches would not be GSP eligible.

A $10 customs value benchmark, which would be indexed to inflation, might serve this purpose. We believe the Virgin Islands watches and their competition enter the United States at significantly higher values.

I would like to add just one point because of the conflicting testimony on price ranges. There is an overlap. Many companies have a price range that goes way down and goes way up, but the question is where most of the watches are sold. Timex is and has always been a low-price company in the under $30 area of concentration.

Mr. **Wein**. I really would appreciate a statement from Mr. Marsching as to how many watches Timex sells from $30 and up.

Chairman **Gibbons**. That is up to him.

Mr. **Wein**. Which is the exact range of Virgin Islands merchandise.

Chairman **Gibbons**. There seems to be in my mind, from the testimony, some area of overlap. I don't know how great the overlap is, and this question was suggested to me by staff. We always try to make these bills as noncontroversial as possible, and we recognize the unique status of the Virgin Islands being a part of the United States but not having a representative here directly on the committee or a voting right in Congress, although they have a very effective representative in Mr. de Lugo.

So we kind of lean over backward to make sure we treat the people fairly in those areas, and that is why I asked that question. Do any of my other colleagues have questions?

Mr. **Frenzel**. Mr. Chairman, I do.

Mr. Wein, you indicated you were concerned about GSP preferences. Is it not true that under GSP, there are limitations on the amounts that can come into this country based both on dollar and on percentage of market figures?

Mr. **Wein**. Yes, sir.

Mr. **Frenzel**. So while you might have increased competition, is it still likely you would be diluged with those limitations protecting you?

Mr. **Wein**. Regrettably, it doesn't take much to drown us.

Mr. **Frenzel**. Thank you.

Mr. **Pease**. Mr. Chairman, could I ask Mr. Wein, is your operation in the Virgin Islands?

Mr. **Wein**. Yes, sir.

Mr. **Pease**. Exclusively?

Mr. **Wein**. No. We have an operation in Chicago where we do the final assembly and marketing of watches under our two brands, Clinton and Benrus.

Mr. **Pease**. And how many watches over $30 value are shipped from the Virgin Islands, not by you, by everybody?

Mr. **Wein**. The production last year in the Virgin Islands was about 2.5 million.

Mr. **Pease**. 2½ million?

Mr. Chairman, I would like to ask Mr. Marsching how many watches over $30 Timex produced last year?

Mr. **Marsching**. That is very highly confidential information. I would be glad to try to discuss this later with the committee. Our competitors would love to know. I can only say that the vast preponderance of our watches are in other price ranges, and two things that—lower price ranges—and two points should not be ignored. First, watches do not compete on the basis of price alone. They compete on the basis of brand name, styling, reputation, warranty and jewelry-like features in which we are quite different from Virgin Islands watches. Second, for an issue like this in which the committee hears conflicting testimony, there is an administrative process which is designed to have an expert agency examine this very issue and report. We are not giving watches GSP by this bill. We are merely giving them the same chance that other products have.

Mr. **Pease**. OK. Fine. I did not mean to press you for proprietary information.

Mr. **Marsching**. I understand.

Mr. **Pease**. Thank you, Mr. Chairman.

Mr. **Wein**. If I may make one last comment, Mr. Chairman, it is not impossible that the total production of the Virgin Islands, the 2.5 million, is matched piece for piece by Timex production in the identical price categories.

Chairman **Gibbons**. All right. Well, go right ahead.

Mr. **Marsching**. Sorry. I just wanted to note the value bracket compromise that we have mentioned, would solve this problem because it would eliminate the higher-priced watches that compete with the Virgin Islands watches from entering the United States with the benefit of GSP.

Mr. **Gates**. If I might add to that, Mr. Chairman, Mr. Wein's testimony, if you will recall, cited the difference between the 42-cent saving, for the average Timex watch, and his higher price watch in which he cited would have a $2 to $5 duty saving. Well, that clearly is the thrust and the significance of the possible compromise that we have developed at the request of various people.

Chairman **Gibbons**. I encourage all of you to work with our staff and see if we can't work out as much justice in this bill as possible. Thank you for coming.

We are now going to take up H.R. 2225. We have a panel composed of the Honorable Ben Blaz, the Honorable Congressman from Guam; and the Honorable Edward D. Reyes, who is Lieutenant Governor of Guam; and the Honorable Pedro A. Tenorio, Lieutenant Governor of the Commonwealth of Northern Mariana Islands.

STATEMENT OF HON. BEN GARRIDO BLAZ, A DELEGATE IN CONGRESS FROM GUAM

Mr. **Blaz**. Thank you very much, Mr. Chairman.

In particular, thank you for allowing us the additional few minutes so we could permit the Lieutenant Governor of Guam to join us.

Chairman GIBBONS. Happy to have him here.

Mr. BLAZ. Thank you very much.

Mr. Chairman, I have a statement that I will submit for the record and request that it be inserted in the proceedings. Obviously, sir, I am here in support of the bill that Mr. Frenzel and I introduced, H.R. 2225. In the interest of saving time, what I would like to do at this point is to make a verbal statement and then yield my time to those accompanying me.

As you know, Mr. Chairman, a few months ago I appeared before this committee and at that time the purpose of my appearing was simply to ask you if we could keep the territories from being foreign countries. As you also know, sir, I was singularly unsuccessful. I am still listed as a foreign country. I hope that that loss will be compensated by some gains today, and I am again appearing in behalf of the industry on Guam.

What we have here, sir, is an opportunity to save an industry in our territory that means so much to the revenue and to the people of Guam. Let me just give you the terms under which I think you can better appreciate our dilemma. We are talking about 300 employees and perhaps 300 employees is not very many when you are thinking in terms of thousands in other places. But if this were the State of California, 300 employees would translate to 75,000 employees and that is the magnitude of the impact negatively on the Territory of Guam to lose this industry.

Second, I wish to reiterate also that in this day and age when we have so many concerns about the deficit, Guam's attempt at deriving revenue from private industry is exceedingly important. And finally, before I introduce the members of the panel, I want to say that when you talk about Guam and you talk about saving an industry of Guam I urge the members to think in terms of the significance of this territory to our country.

I don't think there is a single member that does not realize in the last few years Asia, the Pacific rim has continued to play an increasing importance to our country and to the world, and the one bridge, the one bridge that America has to Asia is the American Territory of Guam. That bridge is going to see an increase in traffic in great quantities in the next few years.

That bridge is now in need of maintenance and in need of repair and what we are here to ask you is that to permit us to protect the American garment industry is Guam, the American workers in Guam, who help us derive the revenue that we need to maintain that bridge and to keep it in good order.

[The prepared statement follows:]

STATEMENT OF HON. BEN GARRIDO BLAZ, A DELEGATE IN CONGRESS FROM GUAM

Mr. Chairman and members of the subcommittee, I am Ben Blaz, the Delegate to Congress from Guam.

I first want to extend to you, Mr. Chairman, and your subcommittee members my sincerest appreciation for your efforts in scheduling this hearing on a matter of great importance to Guam. I am most appreciative.

I appear before you today to speak in support of H.R. 2225, a bill designed to preserve a substantial part of the existing private enterprise in the Territory of Guam.

This Congress has long recognized that if the Territories are to prosper and pay their own way then allowance must be made for the Territories' small size and lack of significant natural resources. We do not have large deposits of mineral ore nor do we have large populations to man the Engines Of Commerce. We also do not have large amounts of local capital with which to build up our economy. What we do have are onerous Federal regulations and laws which were not designed with our best interests in mind and which further disadvantage us in competition with our low-wage, populous foreign neighbors. Companies in the Philippines do not have to comply with the Fair Labor Standards Act. Companies in Hong Kong do not have to obey OSHA. Corporations in South Korea do not have to abide by the dictates of the Clean Air Act. In Guam, however, we do.

This Congress has long known the economic predicament of the territories and has consistently acted to stimulate the development of their industry and trade. The current statement of that policy is contained in General Headnote 3(a) to the Tariff Schedules of the United States. Under Headnote 3(a) articles which are manufactured in the Territories with no more than a certain percentage of foreign materials by value are not subject to duty when shipped to the United States. Under this policy a textile firm from New York came to Guam with the full blessings of the Customs Service and set up a modern factory at a cost of $1,500,000 to manufacture sweaters. This factory now employs nearly 300 Guamanians at wages well above the minimum. An annual payroll of over $1,800,000 and taxes in excess of $75,000 mean a lot to a small territory such as ours. It stands as a monument to our faith in the fairness of this Congress and the promise of free enterprise. It will help us to shoulder the burden of the cuts in Federal spending which the Gramm-Rudman Act mandates—cuts which the U.S. citizens in Guam will feel as will all other Americans.

Unfortunately, the very industry which we have labored to create and which could help to see us through this era of belt-tightening is once again threatened by Federal regulation. We cannot survive if private industry is hamstrung and Federal support is removed. It is that simple.

The U.S. citizens in Guam have always struggled in the face of overwhelming federal constraints to create private industries. What shocks us is the extreme fervor which now drives certain governmental and private groups in their effort to crush the small textile industry in Guam. On August 2, 1985 the customs service published a notice in the Federal Register of a proposed change in duty practice. This proposed duty practice combined with the revised country of origin rules also published by Customs last year will eliminate any practical benefit to Guam and the other insular possessions in Headnote 3(a). The apparel industry in Guam, U.S.A. will cease to exist on the day duty is imposed on the apparel which it manufactures and ships to the United States; 300 Guamanians will lose their jobs. This is equivalent to the loss of 75,000 jobs in California. The effect in Guam will, though, be far worse than in California since there are precious few other jobs in Guam to absorb the unemployed.

The loss of business, wages, and revenue is only part of the impact of the evisceration of Headnote 3(a). The strategic and symbolic importance of Guam in the troubled Western Pacific cannot be forgotten. We in Guam want to remain a beacon of democracy and a model of U.S. enterprise in the Pacific. Without the promise of a viable private industry and a sense that Guam is indeed a part of the United States in both wealth as well as responsibility then Guam cannot fulfill its leadership role. Without my bill and the continuation of the incentives in Headnote 3(a) the well of private investment will dry up and the promise of a prosperous, exemplary American territory of Guam will cease. This Nation's tenuous presence will be further weakened in the Pacific where the future of the world lies.

I ask for your support for H.R. 2225 to preserve the existing industry and investment in the territory of Guam today and the promise of a prosperous commonwealth of Guam tomorrow. Thank You.

Mr. BLAZ. At this time I would like to yield my time to Mr. Steve Segal, the chairman of the board of Sigallo, which is the industry in question, and then Mr. Reyes.

STATEMENT OF STEVEN F. SEGAL, CHAIRMAN, SIGALLO-PAC LTD. OF GUAM, AND PRESIDENT, SIGALLO LTD. OF NEW YORK, ACCOMPANIED BY HARVEY A. ISAACS, COUNSEL

Mr. SEGAL. Thank you, Congressman. I have with me today Harvey Isaacs, of Siegel, Mandell & Davidson, who has also filed a written statement. In 1981, because of several written rulings from Customs and the law of the headnote 3(a), we were forced to start a sweater-manufacturing plant in Guam since it would be a product of Guam and duty-free. The next 2 years we built this plant.

We trained 300 workers. We experienced a logistic nightmare which we never thought we would have. There was no support industry. There were no people to help us for parts, for boilers breaking down, and we lost 60 percent of the net worth of our firm to do this.

Finally, we turned the corner in 1984. We became the first successful textile operation in the territories where we produce McGregor sweaters. Then the nightmare started again.

In 1985 the rules of origin came into effect so what was at one day a product of Guam the next day was considered a product of China or the Far East and we would have to pay duty. There was no way we could exist that way. We were Americans on Guam. Our operators earn over $5 an hour. We could not compete with the Orient. Without a tariff preference, the factory would have to close. It's a very high cost to manufacture on the islands.

In summary, I speak to you about the fairness. The fairness of Americans who risked our capital as private sector investments, trained workers, trained people and became successful and from some administration rulings we certainly are now considered a foreign country which would put us out of business.

Thank you very much.

[The prepared statement follows:]

Sigallo Ltd.

MANUFACTURERS AND IMPORTERS OF FINE KNITWEAR AND OUTERWEAR

SUMMARY OF TESTIMONY IN SUPPORT OF H.R. 2225

Chairman Gibbons and members of the Committee, I will briefly summarize my written testimony in regard to H.R. 2225, and I will then be pleased to answer any questions you might have.

My name is Steven F. Segal and am appearing on behalf of Sigallo-Pac Ltd. of Agana, Guam and its affiliated company, Sigallo Ltd. of New York City and Charleston, South Carolina. Presently, we make knit-wool sweaters on Guam from imported components for sale to the United States. Our workers, all of whom are U.S. citizens or residents, are paid wages substantially above U.S. minimum wages, and equal to or above those paid to workers in comparable jobs in the States. We are proud that our products do bear such well-known labels as McGregor, Wrangler and Dunlop.

Because we started this operation "from scratch" in 1981, we incurred extraordinary expenditures in construction of the plant, purchase of equipment, worker training, etc. When we finally went into production, we had to meet the special logistical difficulties caused by Guam's remote location. We were commercial pioneers on the island, and after several years of losses, the business finally became profitable in 1984.

All of this was done in reliance upon written rulings we obtained from Customs Service Headquarters holding that our sweaters were products of Guam for tariff purposes, and free of duty under General Headnote 3(a) of the Tariff Schedules. But now Customs' "country-of-origin" regulations issued in 1984 gravely threaten our business. In August of 1985, Customs published a notice proposing to revoke its prior rulings, and make our sweaters fully dutiable at the same rates applicable to sweaters imported from foreign countries. Should this happen, Sigallo-Pac would be out of business, because we could no longer compete with similar sweaters made in the Far East with low-wage labor. Our 300 employees in Guam would be unemployed and become dependent on public assistance. The positions of an additional 105 employees of our U.S. affiliate would also be jeopardized.

To save Guam's textile industry, Mr. Blaz and Frenzel have introduced H.R. 2225 which would preserve the present duty-free status for our products. I hope the members of the Committee can support this bill.

In regard to quotas, we are presently subject to import restraints imposed by the Committee for the Implementation of Textile Agreements, which in effect treats Guam as if it were a foreign country. H.R. 2225 in no way affects or negates these restraints - it only codifies the present duty-free status.

In short, we took great risks and invested great sums of money in a place which is in every sense of the word a part of the United States. Because of technical interpretations of the law by the Customs Service which everyone concedes were intended to curtail abuses by the major textile exporting countries, we have been isolated and are now to be thrown in the trash pile. It violates the most basic tenets of American fair play. I also guarantee you that this result will insure that no sane person will every again invest one dollar in Guam nor can the insular possessions trust the United States to live up to its obligations - both legal or moral.

I wish to thank you for this opportunity to speak here, and I'll try to answer any questions you may have.

STATEMENT IN SUPPORT OF H.R. 2225, RELATING TO THE CUSTOMS TREATMENT OF CERTAIN WEARING APPAREL PRODUCED IN U.S. INSULAR POSSESSIONS

Chairman Gibbons and members of the Committee, I am pleased to testify before you in regard to H.R. 2225, which we support. My name is Steven F. Segal and I am Chairman of Sigallo-Pac Ltd. of Guam and President of its United States affiliate, Sigallo Ltd. of New York City. Sigallo-Pac is a manufacturer of men's knit wool sweaters. We are the sole garment manufacturer on Guam and the largest single employer on the island. However, our business is now threatened with overnight extinction by a Customs change in policy with regard to wearing apparel produced in an insular possession. Thus, enactment of remedial legislation is urgently required.

BACKGROUND

Under a national policy dating back to 1902, products of Flag Possessions have been granted a duty advantage, to encourage local industry and labor, and local capital formation and investment. Thus, under General Headnote 3(a) of the Tariff Schedules (TSUS), products of insular possessions meeting the statutory value requirements are entitled to duty-free treatment.

Sigallo-Pac assembles sweaters from component parts knitted abroad. The company was formed in Guam in 1981. Establishing it as a going concern was considerably more difficult and costly than anyone could have anticipated. Prior to this, it was of critical importance to obtain, in advance, rulings from the United States Customs Service that the sweaters which we planned to manufacture from foreign components, qualified as a product of Guam and were entitled to duty-free treatment under General Headnote 3(a), Tariff Schedules of the United States (TSUS), covering products of insular possessions. The plant was established in reliance upon the rulings we obtained. In all, we secured three rulings, holding in each case that the work done by us was a substantial manufacturing process and hence, our finished sweaters were a products of Guam, U.S.A. and could be imported duty-free.

When our operation started, there was not a single trained sewing machine operator in Guam. Such training was both difficult and costly. In was necessary to bring in supervisory and training people from the U.S. mainland - at substantial salary incentives to relocate - to engage in all aspects of worker training. Thus, every present employee represents an extremely large outlay for training: each of them requiring from 6-16 weeks at pay scales substantially above U.S. minimum wages. Today, we have 300 workers, representing a substantial investment in training costs and an investment of approximately $1,500,000 in start-up costs. This figure continues to mount because of a high labor turnover.

Creation of our physical plant presented some special and, once again, costly challenges because of Guam's location. In this remote Possession, 7 air hours from Hawaii, we acquired a bare, unused warehouse and converted it into a modern factory. This entailed (beside the gutting and rebuilding of the interior) the installation of textile machinery, boilers, electrical lines, washing and pressing equipment, etc. Our investment in plant and equipment far exceeded our initial estimates.

In addition to our employees in Guam, we have 75 employees in New York supervising the administrative and sales aspects of the business. Our warehouse facility in Charleston, South Carolina employs an additional 30 people and contributes substantially to the economy of the port.

In the summer of 1984, we finally turned the corner and all this cost, time and effort culminated in the first successfully-operated apparel manufacturing company in the history of Guam (or, for that matter, any other insular possession). Our modern air-conditioned plant has been described by the United States Department of the Interior as "a model factory" epitomizing the Administration's goal for the economic development and independence of Guam.

But our work in Guam is only part of the story -- we also had to find a market for the products from our new facility. Although we had a long-standing reputation in the United States, it was necessary to meet and overcome our customers' natural resistance to products from a new location, previously unheard of in the garment trade. We are proud that our sales efforts were successful. Our sweaters carry such well-known brand names as McGregor, Wrangler and Dunlop, and are sold in stores throughout the country.

However, this too was accomplished only by developing new skills and techniques to meet the logistical difficulties, imposed by Guam's remote location, on the flow of raw materials into the plant and the timely shipment of the finished product to our customers. For instance, a five-month lead time is required to order the yarn for the fabrics used in our sweaters. This requires extremely long-range planning and entails substantial additional financing costs. Moreover, it takes 45 to 50 days for shipment of the finished product to our warehouse in the United States, almost twice the shipping time from Hong Kong or Taiwan. I might add that we use only U.S. Flag vessels.

I should also mention that on Guam, we started operations totally devoid of the usual supporting industries and trades - mechanics, repair services, spare parts suppliers, etc. - that are normally found in a garment manufacturing center. These resources had to be developed locally, or failing that, can only be acquired at great expense. For instance, replacement sewing machine parts, boiler parts, etc., which are immediately available in the mainland, require shipping times of weeks or months.

What we created literally from scratch is now threatened because of the "war" being waged between foreign and domestic wearing apparel textile producers over U.S. market shares. Every one of our workers is a U.S. citizen or resident paid substantially above minimum wages, and we are treated as if we were a low-wage foreign factory. In this conflict, we are a part of America caught in the cross-fire of close hostilities between the major textile exporters and the United States domestic producers. We are a "hybrid" operation, if you will: we use imported components in Guam, but the labor which makes the garments on the island is American and paid at or above that of workers in the States. In addition, Sigallo's 75 employees in New York, servicing this and other aspects of our business, represent an annual payroll of approximately $1,500,000. We are also a major customer of the port of Charleston, S.C., and the public warehouses we use.

GUAM'S CURRENT QUOTA SITUATION

On May 9, 1984, President Reagan issued an Executive Order Intended to toughen administration of the United States textile import program. Subsequently, in response to this directive, the Customs Service issued interim "country-of-origin" regulations, which were made applicable to shipments from foreign countries and insular possessions, and which, as applied to Sigallo-Pac's shipments, created the legal fiction that when our completed sweaters are imported into the United States, they should be treated "as if" they were shipped here directly from the country of production of the components. The new regulations produced the astonishing result that in the sight of Customs, Sigallo-Pac and Guam simply ceased to exist.

As a result of negotiations between the government of Guam and the Administration and based upon our past shipping history, the Committee for the Implementation of Textile Agreements (CITA) announced on March 4, 1985 that a quota of 160,000 dozen cotton, wool, or man-made fiber sweaters assembled in Guam would be permitted entry into the United States for the year ending October 31, 1985; for the current quota year, this quantity was increased by 1%, to 161,600 dozen. The legal authority for this action was 7 U.S.C. 1854, a statute which authorizes the President to negotiate textile and textile product quotas *"with representatives of foreign governments"*. So, under another startling legal fiction, Guam, an insular possession of the United States, became a "foreign government". Nevertheless, without this quota and the cooperation of the Commerce Department and other agencies concerned, we would have been out of business today.

Not long after the initial quotas were announced, the Customs Service published its *final* textile-product rules of origin which, over many objections, including those of Federal agencies, charged with responsibility for administration of Guam, retained the insular possessions within their scope. Customs rigidly insists that the trimming and joining together of otherwise complete knit-to-shape component parts by sewing and linking, even when accompanied by other processes such as washing, pressing, mending, etc., do not constitute a "substantial transformation" of the components into sweaters in Guam, and accordingly, garments so assembled would not be considered a product of Guam. Customs' position in this respect is completely inconsistent with the conclusion reached in the earlier rulings we obtained from the Government before we built our company, which qualified Sigallo-Pac's sweaters as a product of Guam under General Headnote 3(a). In fact, one ruling said that *it was not enough to "substantially transform" the components in Guam - - that a tougher test must be met, namely that the components be subjected to a "substantial manufacturing process"* (Headquarters Ruling Letter 071303 of June 16, 1983). Thus, before the new "rules of origin" were promulgated, what we were doing in Guam was considered to be *more than* a substantial transformation, but by some bureaucratic legerdermain, the same work has been reduced to something *less than* a substantial transformation.

In a Federal Register notice of August 2, 1985, Customs advised the public that a "change of practice" notice was legally required to complete the exercise commenced in 1984 and will result in our sweaters becoming *fully dutiable*. Of course, we are registering vigorous objections to this *de facto* repeal of General Headnote 3(a), but we are almost certain that having placed the noose over our head, Customs will spring the trap and conclude that our sweaters are fully dutiable at the same rates for such sweaters when shipped from the country-of-origin of the components. Such treatment spells the end of Sigallo-Pac's operations, because we cannot compete with similar sweaters imported directly from Hong Kong, China, Taiwan or any other Far Eastern country, made with the use of low-wage foreign labor, because our operators make substantially above minimun wage, equal to or exceeding pay scales for their counterparts on the U.S. mainland..

REMEDIAL LEGISLATION, AS PROVIDED FOR IN H.R. 2225, SHOULD BE PROMPTLY ENACTED BY THE CONGRESS

To prevent the demise of the textile industry on Guam, Mr. Blaz and Frenzel have co-sponsored H.R. 2225. This bill would revive the obligations which the United States has historically exercised towards its Flag Possessions, specifically in regard to the special tariff status afforded their products; it would preserve the present duty-free status for such products, but would leave in place those import quota restraints imposed by the Administration. The urgent need for this remedial legislation is underscored by the damage already done by Customs' threats to make our products fully dutiable. I refer to the cloud upon our plans to sell and ship goods; to the noticeable loss of confidence in us by our customers, banks and other financial institutions; and to the decrease in employee morale both here and in Guam.

We made a business decision to build a company in Guam. We complied with every law and met every challenge. Although each facet of building the factory was more costly and time-consuming than anyone could have possible predicted, we still felt our decision was correct and believed we had the full support of the United States Government. Should the Congress fail to pass this remedial legislation, I have no hope for our business, or for the eventual economic independence of Guam. If Sigallo-Pac ceases operations, the social and economic consequences would be devastating. Our annual payroll in Guam, in excess of $1,600,000, would be lost to the island's economy. Those workers thrown into idleness would be hard-pressed to find other jobs and contribute to an increase in Guam's present high unemployment rate; it would also increase Guam's public assistance outlays, largely U.S. - subsidized. Worker dependency would increase; worker contribution would lessen. Service industries would also be hard-hit -- Sigallo-Pac is the second-largest shipper on the island, and generates approximately $500,000 in annual income to U.S.-flag lines. Other sectors, such as the local power company and the Port Authority of Guam (including stevedores and longshoremen), would also be hurt by the loss of substantial revenue. The chances of Guam ever again attracting private investment capital for manufacturing would be virtually zero, and its requirements for continued monetary assistance from Washington would doubtless increase.

I staked 50 years of work and my entire business on the start-up of this factory, and think it is unfair and unreasonable that it should be put at risk by an administrative re-interpretation of the textile rules of origin. Sigallo, Ltd. lost $1,600,000 (between 60-70% of its net worth) to start up this business. We did exactly as the government induced us to and complied exactly with the requirements of the technical rulings issued to us. In spite of very difficult obstacles, we have made this plant work--but we cannot survive if the rules are so drastically changed after the fact.

For Sigallo-Pac alone, approximately 300 jobs are at stake in Guam and an additional 125 in the United States, which have been unnecessarily placed at risk by the ongoing warfare between foreign producers and domestic manufacturers over shares of the U.S. wearing apparel market. All we ask is the chance to preserve what we have so painfully built up, the chance to compete fairly with overseas producers, recognition of the people of Guam as United States citizens, nationals, and residents, and reaffirmation of the beneficial and long-standing Congressional policy towards products of our Flag Possessions.

Mr. **Pease** [presiding]. Thank you very much. Who would like to testify next?

Mr. **Blaz**. The Lieutenant Governor of Guam, Mr. Reyes.

Mr. **Pease**. Thank you. You are recognized.

STATEMENT OF EDWARD D. REYES, LIEUTENANT GOVERNOR, TERRITORY OF GUAM

Mr. **Reyes**. Honorable members of the subcommittee, on behalf of the people of Guam, thank you for the opportunity to express our views on H.R. 2225. In the interest of time, I will summarize my testimony which I have submitted for the record. I would like to state categorically at the outset that we support H.R. 2225. It is the first step to averting a serious catastrophe to Guam's single light manufacturing industry, Sigallo-Pac, Ltd.

This was the first manufacturing light industry to bring its business to Guam. Sigallo took that risk based on the premise that Guam products will be quota and duty free pursuant to headnote 3(a). As a result of recent changes, Sigallo stands to lose millions of dollars in investment, 300 Americans would lose their jobs, and it shall reverberate throughout the United States and Asia that Guam is not a good place to do business.

Members, the purposes of headnote 3(a) was intended to assist the U.S. territories to develop their economies in view of their unique relationship to the United States. Although we have come a long way, Guam still needs this benefit unaltered by regulation which erode its significance. We are a developing territory surrounded by water at the gate of Asia, geographically separate from the United States, but we are in every way proudly American. These facts and circumstances must be recognized in any economic policy to the territories of the United States.

In conclusion, as loyal Americans we are ready to give our lives and our blood for our country, but we also stand ready to enjoy its fruits. We stand ready to make economic sacrifices for our Nation but we are also anxious to share in the rights and privileges. We also are an integral part of America's past, but more importantly we are a vital part of America's future, politically, socially, strategically and economically. Once again, we request your support of H.R. 2225. Thank you very much.

[The prepared statement follows:]

Statement of Edward D. Reyes, Lieutenant Governor of Guam

Chairman Gibbons and honorable members of the subcommittee, thank you for allowing me to appear before you today.

I am Edward D. Reyes, Lieutenant Governor of Guam. I am here today to present testimony regarding the proposed amendment of General Headnote 3(a) relating to the Customs treatment of certain wearing apparel produced in the insular possessions of the United States market.

GUAM'S TEXTILE INDUSTRY

The proposed duty suspension under H.R. 2225, if accepted, will substantially benefit Guam from previous restraint measures that have adversely affected the development of Guam's textile industry. The proposed measure ensures a positive move toward remedying our present textile predicament. Thus, we support the intent behind H.R. 2225. Through H.R. 2225, Guam hopes that it will be granted more liberal and equitable trade treatment to promote the national and economic interest of the United States, as it applies to all of her citizens. At present there is only one

Guam textile firm which originally operated under the guidelines of General Headnote 3(a), but it now is subjected to a local certification arrangement which effectively imposes a quota for textiles from Guam. This arrangement was provided for by the United States Trade Representative as an interim solution to protect Guam's existing operations. Not conforming to 19 CFR 12.130(d) may result in textiles being subjected to the imposition of duties upon entry into the U.S. Customs Territory.

It is of particular concern to the Government of Guam that industries capitalizing on the General Headnote 3(a) trade incentive make a meaningful contribution to the island. It is essential to note that the congressional intent behind General Headnote 3(a) is to have it serve as a direct stimulus to establish viable industries and to develop the economies of the insular possessions. Exercising this intent as a beneficiary of General Headnote 3(a) oftentimes has been countered with arbitrary trade measures designed for major exporting countries.

A current example illustrates the inclusion of Guam as a foreign country having U.S. bilateral agreements, along with 37 other major exporting countries, as presented in a recent customs directive which imposes a monitoring standard for textiles. The directive that I refer to is Customs Directive number 3500-06 for Textiles and Textile Products which was recently issued by U.S. Customs.

The questions and concerns that remain lie with a positive and progressive treatment of Guam's developing trade potential, particularly for the only currently significant local manufacturing industry. The vulnerability of Guam's textile industry to U.S. textile restraint measures will continue to impede the development of a viable industry, which is presently dependent upon favorable U.S. textile provisions. U.S. insular possessions have, in the past, been subjected to federal regulations inappropriately applied, and in many instances have served as trade laboratories that have been unfairly treated.

H.R. 2225 allows insular possessions the needed mitigation of restraint to operate appropriately within a trade sensitive environment. It seems that the arguments in favor of the U.S. textile industry are noteworthy. We can only sympathize to a degree, though, in that the arguments can be applied to Guam as well although on a smaller scale. The number of jobs that would be threatened, a plant closing, and other support services that would be affected if Guam's trade status is continually treated in a haphazard manner need to be addressed at some time if the Federal government's admonishment that our economy become more self supporting is to even be placated.

LOCAL GARMENT INDUSTRY

The island's only textile firm is a pioneering entity, currently employing approximately 300 garment workers. Such investment considerations afford the opportunity for Guam to develop and utilize local resources to support an industry that can properly and independently operate of its own accord. This type of industry would lend positive benefits to Guam's fledging economy.

H.R. 2225 should serve as a precedent for future treatment of import sensitive products entering the U.S. Customs Territory. In this case, treatment of textiles, as applied to the U.S. Territories, should be governed by the proposed provisions. They should be allowed to be shipped into the U.S. Customs Territory without duty under General Headnote 3(a). H.R. 2225 provides a simple and effective solution of resolving Guam's textile dilemma. The circumvention issue is not that the abuses are rampant on Guam. Perhaps the screening of requests to export to the U.S. from countries not subjected to textile restraint levels should be reviewed and monitored more closely. Further, this legislative opportunity should also provide for flexibility in extending similar treatment for other trade sensitive products eligible under General Headnote 3(a).

STRATEGIES FOR GUAM

We believe that the overriding importance of the Pacific Basin to U.S. trade is fast becoming a reality, and the role that Guam plays is becoming more critical. On behalf of the people of Guam, we are seeking favorable support of H.R. 2225 and favorable consideration in adopting the following recommendations:

1. That for purposes of U.S. law and future regulations regarding U.S. insular possessions, Guam be treated no differently than any of fifty states.
2. That Guam, as a U.S. insular possession, be treated on a par with those foreign nations falling within the scope of the Caribbean Basin Economic Recovery Act and the treatment granted to the European Economic Community.

Guam's economic status vis-a-vis the United States should be clearly defined. H.R. 2225 exemplifies our trade concerns and the positive consideration we have been seeking and arguing for time and time again. U.S. insular possessions are obviously in need of a Pacific trade policy which would allow for the needed flexibility and opportunity to adjust accordingly to trade and market conditions. More specifically, a Pacific Basin Initiative should be considered for the U.S. Insular Possessions. Granting such a policy may be the key to our effective and timely development.

I would like to thank you for allowing me to make this presentation on Guam's behalf. We are grateful that the Congress, however belatedly, is showing signs of interest in extending fair treatment toward our efforts to develop economically.

Mr. PEASE. Thank you, Mr. Reyes. Does anyone else wish to testify?

Mr. BLAZ. Yes. Mr. Tenorio is here and would like to testify.

Mr. PEASE. Mr. Tenorio, you may proceed.

STATEMENT OF PEDRO A. TENORIO, LIEUTENANT GOVERNOR, COMMONWEALTH OF NORTHERN MARIANA ISLANDS

Mr. TENORIO. Thank you, Mr. Chairman. For the record, my name is Pedro Tenorio. I am the Lieutenant Governor from the Commonwealth of the Northern Mariana Islands. For the information of the committee members, the Northern Mariana Islands are located approximately 100 miles north of Guam, so we are a very close neighbor with Guam. We do share some of the problems that they are encountering. We are proud to say in 1976 the Northern Mariana Islands entered into an agreement with the United States to be a part of the United States political family.

We voice strong support for H.R. 2225, a bill relating to the customs treatment of certain apparel produced in the insular possession of the United States. This measure would provide substantial relief to the harsh impact of last year's country-of-origin regulations, formally known as Customs Regulations Amendment Relating to Textiles and Textiles Products, 50 Fed. Reg. 8710, March 5, 1985. This bill would treat garments assembled in the insular possessions from knitted component parts as if they were products of the insular possessions, and so ensure that they were properly exempted from duty under headnote 3(a).

This measure would restore certainty to an industry so vital to our fragile island economies. In the Commonwealth of the Northern Mariana Islands, the garment industry provides the only economic alternative to a fledgling tourist industry. On the whole, we in the Marianas have no natural resources; we lack a skilled labor force; we are removed from U.S. markets; transportation and communication facilities are vastly underdeveloped; infrastructure cannot meet basic needs; and, labor is subject to minimum wage laws.

We receive Federal financial assistance but had hopes that with this industry, we would be able to relieve the Federal burden by gradually realizing economic self-sufficiency in the excise taxes, gross revenue taxes, wage and salary taxes, user fees, and new employment opportunities that this industry contributed to our economy. On a strictly financial basis, therefore, we urge passage of H.R. 2225 without any change.

Of even greater significance, however, is that H.R. 2225 will prevent the destruction of this important territorial policy. The committee is aware of the vital importance of general headnote 3(a) to the economic development efforts of the territories and insular possessions of the United States. For more than 80 years, offshore territories of the United States have enjoyed special trade preferences under Federal law; and for 50 years general headnote 3(a) and its statutory antecedents have been bipartisan Federal policy to foster development in the territories and possessions. Under the headnote, products of the island territories have entered the customs territory of the United States without quota and duty free. Our Commonwealth negotiated for and received this development incentive in our covenant with the United States, Public Law 94-241, 90 Stat. 263, "A Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America."

Lastly, the Customs Service also asserts that these new regulations empower it to levy duty on these imports from the territories regardless of whether or not they qualify under the 50-percent standard of headnote 3(a). It is only the latter problem that is addressed by H.R. 2225. The record clearly demonstrates that Congress intended that an article manufactured in an insular possession and containing no more than 50-percent foreign materials would be entitled to enter the customs territory of the United States without the payment of duty. Congress did not intend that the article be subject to an additional test, that the article be also the growth or product of the possession.

H.R. 2225 will clarify that the country of origin regulations are not effective to render the subject article dutiable under the general headnote 3(a), and I support its passage without amendments. I am hopeful that the Congress can give future consideration whether it is the intent of Congress to regulate U.S. territories pursuant to the foreign affairs authority of section 204 of the Agricultural Act of 1956. There are other devices including one which would impose labor quotas on our industries which would also have the impact of destroying the economic benefits that the garment manufacturers provide to our islands. We urge your support in resisting such proposals.

Thank you for the time. I will be happy to answer any questions.

[The following was subsequently received:]

Office of the Resident Representative to the United States
Commonwealth of the Northern Mariana Islands

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February 13, 1986

Honorable Sam M. Gibbons
Chairman, Subcommittee on Trade
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find a joint written statement for the record of the hearing on H.R. 2225, a bill relating to the customs treatment of certain wearing apparel produced in the insular possessions of the United States. This statement is intended to supplement testimony offered in support of H.R. 2225 by each of us previously. This supplemental information is by way of responding to certain specific amendments suggested to the Committee by the Assistant Secretary of Interior for Territorial and International Affairs in a letter to Chairman Rostenkowski on October 23, 1985.

We both hope to make it clear that the Commonwealth of the Northern Mariana Islands' support H.R. 2225 does not extend to the proposed amendments offered by the Interior Department. Indeed, should the Subcommittee decide to adopt the Interior amendments, we would oppose the enactment of H.R. 2225.

The Resident Representative wrote to you in August of 1984 expressing the grave concern that we felt about the "country of origin regulations" which had just been published as interim regulations. As you know, those regulations were made final last year. They have already sharply reduced production and employment in this fledgling industry in the Commonwealth.

H.R. 2225 is intended to limit the negative impact of those regulations on the insular possessions of the United States, and so we support it. We appreciated your concern about the regulations at the time that they were issued, and we hope that you will take our opposition to the Interior Department proposal into account during the Subcommittee's deliberations on H.R. 2225.

Sincerely,

Froilan C. Tenorio
Resident Representative

Pedro A. Tenorio
Lieutenant Governor

Enclosures

STATEMENT OF

FROILAN C. TENORIO
RESIDENT REPRESENTATIVE TO THE
UNITED STATES OF AMERICA

and

PEDRO A. TENORIO
LIEUTENANT GOVERNOR
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

before the

SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON H.R. 2225

FEBRUARY 6, 1986

This statement is intended to supplement testimony previously offered by each of us in support of H.R. 2225. We would like to make these additional remarks in order to respond specifically to amendments suggested by the Office of Interior and Insular Affairs, Department of the Interior, in its letter to the Committee chairman on October 23, 1985. Please let the record accurately reflect that the support of the Commonwealth of the Northern Mariana Islands (Commonwealth) for H.R. 2225 does not extend to the amendments suggested by the Assistant Secretary for Territorial and International Affairs. Indeed, we oppose enactment of those amendments and request that the Committee not include the Northern Mariana Islands (NMI) in this measure in the event that the Interior amendments are adopted.

As we have already pointed out in our previous testimony, H.R. 2225 is a well intentioned bill that is designed to prevent further erosion in territorial trade policy caused by the country of origin rules issued last year as "Customs

Regulations Amendments Relating to Textiles and Textile Products", 50 Fed. Reg. 8710 (March 5, 1985). As you know, the country of origin regulations altered decades-old tradition of promoting trade development in the flag territories by defining certain garment products manufactured in the territories, which contained 50% territorial value, as foreign products.

The regulations have been interpreted to make the territorial garments subject to quota restraint, in the case of the Northern Mariana Islands, limited to a modest 73,500 dozen for 1986. These quota restrictions have already caused serious damage to the promising young industry in the Northern Mariana Islands.

The bill would clarify that those regulations are not effective to render such garments subject to duty and would preserve the right to import such garments into the United States without payment of duty, as has been done for many years under the insular possessions exemption of General Headnote 3(a).

THE INTERIOR AMENDMENTS

The Office of Territorial and International Affairs (OTIA) has proposed a set of amendments that would change the effect and intent of this bill. First, instead of supporting the traditional duty-free principles of American territorial trade policy, the Office of Territorial and International Affairs suggests an exemption limited in time to ten years. The OTIA proposal would also impose local labor restrictions, so that a manufacturer would be required to employ 55% local labor initially, and 35% local labor after three years, in order to qualify for the exemption. Finally, the proposal would impose a five-part assembly requirement, making H.R. 2225 considerably more restrictive than the country of origin regulations themselves.

The declared purpose of these amendments is to "effectively impose a ceiling that would limit the number of sweaters entering the mainland from these territories...." In our view, this intention violates a long history of Interior Department economic development policy and planning for the territories. In addition, it is entirely unnecessary since the sweater production of the Northern Mariana Islands is already limited by federal regulation to 73,500 dozen per year.

INTERIOR DEVELOPMENT PLANNING

For more than twenty years the Department of the Interior has had administrative authority to govern the Northern Mariana Islands, with the duty to "carry out the obligations assumed by the United States as the administering authority of the trust territory under the terms of the trusteeship agreement and under the Charter of the United Nations." Article 6 of the United Nations Trusteeship Agreement requires, for example, that the Department of the Interior "promote the economic advancement and self-sufficiency of the inhabitants, and to this end shall...encourage the development of...industries...."

Pursuant to that authority, the Department of the Interior has frequently studied the subject of economic development in the Northern Mariana Islands, along with the rest of the Trust Territory of the Pacific Islands. Every study has noted the need for supplementing the local labor force with imported labor of one kind or another, and the policy of the Trust Territory Government within the Department of the Interior initiated the importation of third-country labor on a large scale. Since as early as 1966, official Department of the Interior policy has recognized that "[t]he small numbers, the low levels of training, and the labor market standards in Micronesia combine to require that almost any kind of sizeable economic expansion in Micronesia must depend largely on imported labor...." Economic Development Plan for Micronesians, (Nathan Associates, December, 1966) at 68. Indeed, the Trust Territory Government itself employed many "third country nationals" and its enthusiasm for imported workers was so great that such workers were paid wages at rates higher than the rates paid to Micronesian employees for the same government employment. It seems ironic that the Interior Department is trying to restrict the use of imported labor now that it is the local Commonwealth government that has assumed the job of regulating the matter.

This need for imported labor to encourage development was repeated during economic planning specifically targeted to the human resource needs of the Northern Mariana Islands during the transition to commonwealth status. The Northern Mariana Islands was counselled not to view the importation of labor in a negative light, because:

> Every economy imports some labor. Even the most economically advanced countries find that their productivity and income are increased by importing the kinds of labor which either they do not have, or which is too highly priced in local labor markets. The U.S. employs millions of unskilled alien agricultural workers, together with hundreds of thousands of skilled and professional aliens. It is not a sign of inadequacy to use alien labor; it can be a sign that improvement in productivity is possible and that employers are anxious to employ the right kinds of workers to achieve greater production.

Socioeconomic Development Plan for the Northern Mariana Islands, (Office of Transition Studies and Planning, October, 1977) at 51.

This study acknowledged expressly that the decisions about how many imported workers should be permitted, and under what conditions, would be important policies to be established by the local government. "The NMI government must recognize frankly that development will mean importing more labor. It must devote more effort to making as certain as possible that everything that can be reasonably done to replace them with local workers will be done." Id. at 58.

The Northern Mariana Islands Government has studiously followed this advice and has instituted a labor policy which permits the importation of outside workers if local talent is not available, while ensuring that new industries will contribute to the local economy by appropriate local hiring policies.

COMMONWEALTH LABOR POLICY

The Northern Mariana Islands Government has devoted a great deal of its administrative resources to the establishment and regulation of a balanced labor policy. The importation of labor into the Northern Mariana Islands is governed locally by the Commonwealth's Non-Resident Workers Act, 3 CMC 4411, et. seq. This law permits the use of non-resident workers only if no resident workers are available. In addition, an employer must show that the specific job position is necessary to the industry, and the NMI government must consider the industry to be desirable in terms of economic development. A copy of the Non-Resident Workers Act and implementing textile regulations are included as an appendix for your reference.

In the case of the garment industry, the NMI government has determined that this new industry should be allowed to import workers during its start-up phase and gradually replace them with local employees as trained local workers become available. All sweater manufacturers are required to begin operations with a minimum of 20% local workers, and each employer must rapidly increase local employment to 40% before the end of 1986. In addition, the Commonwealth has provided strong incentives for the manufacturers to exceed these ratios by requiring that those manufacturers who show the best record for hiring local employees shall receive the largest share of the NMI annual production quota.

In response to fears that the Northern Mariana Islands would become a conduit for fraudulent importations and transshipments into the United States, the Commonwealth invited the U.S. Customs Service to inspect the Saipan industry and recommend inspection procedures that would prevent potential abuses. At the suggestion of the Customs Service investigators, the Commonwealth has implemented very strict inspection procedures, which include criminal penalties for fraudulent practices. These regulations have been endorsed by the U.S. Customs Service visiting team and appear in Article III of the enclosed regulations.

These policies had been working rather well. Last August, statistics on the Saipan sweater manufacturers showed that the industry had already nearly reached the local hiring goals established for next year. The three manufacturers reported that total employment in the industry was 312 workers, of whom 135 were local workers, and 177 were imported, for a total of 43% local employees. This meant that the total local employment figures had already surpassed the 40% target for 1987. Since that time, the country of origin regulations and 73,500 dozen federal quota have forced the closing of one of the factories and layoffs at the other two plants. Ironically these layoffs have lowered the level of local employment in the industry and resulted in a 7% increase in unemployment in the Commonwealth last year.

It must be kept in mind that the Northern Mariana Islands has a very small labor pool. As of July 1985, the Commonwealth's Department of Commerce and Labor reported only 529 unemployed persons. Most of these persons are untrained in manufacturing skills, or live away from Saipan, or are not currently suited for textile factory work. All agree that the local labor requirements in the Interior proposal are not realistic for the NMI manufacturers at this stage. Generally speaking, the NMI government feels that the sweater manufacturers have done a creditable job of maximizing local hiring in this young industry.

The NMI government feels that the short history of this industry in the Commonwealth does not justify the imposition of federal labor quotas. The Northern Mariana Islands negotiated for and received control of its immigration in the status negotiations leading up to approval of the Covenant to Establish the Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Pub. L. 94-241. Any federal regulations that would apply local labor ratios to all territories at the same level cannot take the particulars of the Commonwealth situation into account. We believe to the contrary, that the Commonwealth's legislation and regulation of this new industry demonstrate that the good faith efforts of the NMI government to control unnecessary importation of alien labor and promote local hiring in the factories have been successful.

CURRENT ADMINISTRATION POLICY

Current United States customs policy regarding the importation of the subject sweater categories into the United States from the Northern Mariana Islands is that such importation is strictly limited to 73,500 dozen per year. Duty is not levied upon such garments if they qualify for exemption under the 49% foreign content standard of General Headnote 3(a) TSUS. Although the U.S. Customs Service has published its intention to change its practice and apply duty to the sweaters, that change has not been made final. The Northern Mariana Islands has submitted comments opposing the change on the grounds that such a change would violate the current language of the headnote. In a sense, H.R. 2225 is a preventative measure, in that it solves a problem that does not yet exist.

Beyond this, the administration's policy is not easy to determine. The Interior Department suggests that local labor and other requirements are necessary to preserve the insular possessions exemption which was established by the Congress in Headnote 3(a). It is very difficult for our government to understand what policy considerations justify this suggestion. The Interior Department, and the Office of Territorial and International Affairs in particular, acknowledge a policy objective of "furthering economic development...." In accordance with this policy, "the Department encourages the Northern Mariana Islands Government to explore all means of meeting its financial responsibilities and not to rely solely on direct federal grants. The Department encourages and assists the government in finding ways to increase local revenues." U.S. Dept. of Interior Budget Justifications, FY 1986, at TIA-42. In addition, the Assistant Secretary recently negotiated a new financial assistance agreement for the Northern Mariana Islands which states as policy that "[t]he people of the Northern Mariana Islands will be best served by promoting economic development, [and] lessening dependence on Federal financial assistance for government operations, and reducing the size of government, including the executive and legislative branches." Yet the amendment they propose will rob our

Commonwealth government of its single most promising new revenue base and reduce the employment opportunities available in our private sector.

The only policy justification advanced in support of the proposal is that, "[t]his requirement, coupled with the small populations involved would effectively impose a ceiling that would limit the number of sweaters entering the mainland from these territories and eliminate domestic manufacturers' fears of massive import increases." As we have seen, such a ceiling is already in place for the Northern Mariana Islands, the limit of which is 73,500 dozen per year. If the "domestic" manufacturers are still concerned about massive increases in sweater imports from the Northern Mariana Islands, those fears are groundless.

Actually, the Interior proposal would impose restrictions against the flag territories that are stricter than those imposed by the Customs Service in the country of origin regulations. By notice of the Chairman of the Committee for the Implementation of Textile Agreements (CITA), most recently at 50 Fed. Reg. 42750 (Oct. 22, 1985), the federal government permitted the entry of 73,500 dozen sweaters from the Northern Mariana Islands. The Interior proposal would preserve duty-free treatment for only those sweaters as were assembled from a minimum of 5 component parts. Thus, some of the sweaters that currently qualify under the CITA regulation would no longer qualify for Headnote 3(a) treatment. In our view, this proposal is destructive of the economic development in the Northern Mariana Islands, and is active protectionism against the flag territories on the part of the Office of Territorial and International Affairs.

There are other indications that the Reagan administration is not of one mind on this subject. Shortly after the Interior Department's proposal was sent to the Congress, the U.S. Department of State sent a message to the American Consul in Hong Kong stating that the proposed local hire requirement "does not, repeat not, have the support of the Reagan administration." The issue was, according to the State Department "politically inspired, ill-conceived and without economic justification."

CONCLUSION

For all of the reasons outlined above, we oppose adoption of the amendments offered to H.R. 2225 by the Department of the Interior. We encourage the Subcommittee to reject this proposal because it is unnecessary to accomplish the stated purpose for which it is offered. The "ceiling" on imports already exists, and no discernible federal policy justifies the further restrictions that the Interior proposal would apply to the territorial manufacturers. The local labor requirements contradict a long history of Interior Department practice and planning advice to the Northern Mariana Islands.

The proposal is not supported by all departments of the federal government and is contrary to the general free trade policies of the Reagan administration. The Governor of the Northern Mariana Islands believes that this proposal threatens to alter the trade provisions negotiated in our Covenant with the United States and has invoked the consultation provisions of Covenant section 902 to initiate government-to-government discussions on this subject as a political status issue. Lieutenant Governor Pedro A. Tenorio has been appointed as the special representative to negotiate with the President's representative on this subject. We ask that the Subcommittee reject the amendments and allow the Covenant consultations to proceed at arms length.

FOURTH NORTHERN MARIANAS COMMONWEALTH LEGISLATURE HOUSE BILL NO. 265

SEVENTH REGULAR SESSION, 1985

APP. COMM.

A BILL FOR AN ACT

To provide for a system by which Headnote 3A Import waivers can be fairly allocated among existing manufacturers; to vacate current regulations covering this same topic; to add a new Chapter 5 to 4 CMC Division 5, and for other purposes.

BE IT ENACTED BY THE NORTHERN MARIANAS COMMONWEALTH LEGISLATURE:

Section 1. Amendment. A new chapter 5 is added to 4 CMC, Division 5 to read as follows:

"CHAPTER 5. GARMENT INDUSTRY ACT OF 1985.

ARTICLE 1. GENERAL PROVISIONS

Section 5511. Short Title. This Act may be cited as the Garment Industry Act of 1985.

Section 5512. Purpose. This legislation provides for a division among CNMI sweater manufacturers of import limits placed by the United States upon cotten, wool and man-made fiber sweaters in Categories 345, 445, 446, 645 and 646 of the U.S. Customs Regulations. The sweaters must be assembled in the CNMI from a minimum of four major sweater parcels which originate in a country whose sweater exports to the United Staes are subject to quota.

Section 5513. Findings. The legislature hereby finds:

(a) With the establishment of January 9, 1978 of the Government of the Commonwealth of the Northern Mariana Islands, the Covenant made applicable to the CNMI the General Headnote 3(a) to the Tariff Schedules of the United States, (19 U.S.C. §1202), a country of origin rule drafted specifically for insular possessions of the United States. The rule provides that an article is a product of an insular possession if it does not contain foreign materials exceeding 50% of the total appraisal value of the product.

There are no quota restrictions or other duties applicable to insular possessions.

(b) On February 22, 1983, the United States Customs Service finally and officially recognized that Headnote 3(a) applied to the Northern Mariana Islands under Section 603(c) of the Covenant which provides the same treatment for imports from the Northern Mariana Islands into the United States as imports from Guam into the United States.

(c) Based upon that decision, certain corporations committed large sums of money to locate sweater factories in the Commonwealth and begin assembly operations under Headnote 3(a).

(d) On August 3, 1984, the US Customs Service published interim regulations governing the importation of textiles and textile products into the United States (T.D. 84-171). These regulations, which applied to insular possessions, provide that articles which consist of materials which originated in a foreign country shall be considered as products of an insular possession only if the article has been substantially transformed by means of a substantial manufacturing or processing operation into a new and different article of commerce with a name, character or use distinct from the article or material from which it was so transformed. Therefore, assembly operations in the Commonwealth which were contributing 50% to the final appraisal value of an article could no longer qualify the article as originating in the Commonwealth of the Northern Mariana Islands.

(e) As a result of the interim regulations, the sweater manufacturers were unable to export sweaters into the United States Customs Territory, thereby threatening the existence of the industry in the Commonwealth.

(f) On April 4, 1985, the US Customs Service adopted the interim regulations with minor amendments, as a final rule (T.D. 85-38).

(g) As a result of many months of discussions with the Committee for the Implementation of Textile Agreements (CITA) and the Office of the United States Trade Representative, an Administrative arrangement for the waiver of the regulations for 70,000 dozen sweaters annually was agreed to by the United States Government and the Government of the Northern Mariana Islands on January 30, 1985. A directive from the Chairman of CITA to the US Commissioner of Customs establishes import limits and certification requirements to be effective on April 15, 1985. However, the annual period commenced on November 1, 1984.

(h) The amount of the annual waiver was established by the United States as the annual production capacity of sweater manufacturers which were engaged in manufacturing under Headnote 3(a) in the CNMI.

(i) The sweater manufacturers have provided substantial economic benefits to the Commonwealth. Their factories provide jobs for local people, pay substantial taxes, and enhance our economic image abroad by producing quality products with a "Made in the Northern Mariana Islands" label. Their continued success will enhance our Commonwealth's reputation as a sound place for foreign investment.

(j) The tax benefit to the Commonwealth is derived from a 3% user fee on the invoice value of sweaters sold to buyers in the United States. Therefore, more expensive sweaters result in a larger amount of tax dollars to the Commonwealth.

(k) Recent regulations promulgated by the Commonwealth Government divided these 70,000 dozen sweaters equally among three existing sweater manufacturers without regard to the size of their investment, their productive capacity, the price of their sweaters or the number of local persons being employed by them.

(l) It is necessary to establish a system for the distributi of the United States Customs waiver. The Legislature finds that the distribution system should (1) give an incentive to provide more jobs to local people; (2) maximize the tax dollars collected and (3) take into consideration the size of each factory's investment in the Commonwealth and its production capacity.

ARTICLE II. WAIVER CERTIFICATE

Section 5521. Waiver Certificate. The Chief of the Division of C shall issue a waiver certification to applicants who meet the criteria forth in Section 5522. The waiver certificate will entitle the holder proportionate share of the United States Customs waiver. The certifica shall specify the number of sweaters in the share.

Section 5522. Eligibility for Certificate.

(a) An applicant is eligible for a waiver certificate upon proof of:

(1) incorporation in the Commonwealth of the Northern Mariana Islands prior to January 30, 1985;

(2) a valid license to conduct a sweater manufacturing business prior to January 30, 1985;

(3) CNMI certificates of origin evidencing production in excess of 7,500 dozen sweaters under Headnote 3(a) prior to January 30, 1985; and

(4) full time employment of "resident workers," as that term is defined by 3 CMC 4412 (j), in garment manufacturing operations who compromise the following percentages of the company's labor force:

(A) upon the effective date of this section - 20%;

(B) within 90 days - 25%;

(C) before January 1, 1986 - 30%; and

(D) before January 1, 1987 - 40%.

(5) Failure to maintain this minimum requirement at any time during the year shall cause a certificate to be suspended until proof of compliance.

(b) Application for a waiver certificate shall be made no later than November 7 of each year.

(c) Certificates shall be awarded within 10 days after receipt of application.

Section 5523. Duration of Certificate. A waiver certificate is valid for one year. The Chief of Customs shall reissue certificates annually in November. The Director of Finance may change by regulation the eligibility requirements in Section 5522 if he determines after notice and hearing that there is a significant change in circumstances requiring such a change.

Section 5524. Non-Assignable Certificates. Waiver certificates shall not be assigned, sold, or transferred by the holder to any other person or entity.

Section 5525. Change in Shares.

(a) If the Chief of Customs determines after notice and opportunity for hearing that a company cannot be reasonably expected to use its entire waiver within the year, the share of the company may be reassigned in accordance with Section 5526 to the remaining companies which the Chief finds can reasonably be expected to use the remainder.

(b) If it appears to any certificate holder that the manufacturer will be unable to produce a sufficient number of sweaters in order to use its entire waiver within the year, the holder shall surrender to the Chief the expected remainder prior to August 1. If a company fails to use 100% of its waiver in a year, the unused portion shall be deducted from its shares for the next year. The Chief shall distribute according to the formula in Section 5526 any surrendered remainders or deductions from shares among other certificate holders who can be reasonably expected to use the increase in their shares.

Section 5526. Allocation of Shares.

(a) Rationale. The division of shares of the 70,000 dozen waiver provides an incentive for each manufacturer to employ local workers and to produce sweaters that will maximize the Commonwealth's tax collection. The division also recognizes the size of the manufacturer's investment in the Commonwealth and its productive capacity.

(b) The six catagories upon which the allocations shall be based are set forth in this subsection. Each catagory is separately determined. The waiver shares in each catagory shall be awarded based upon the applicant's proportionate share of each catagory in the 12 months preceding November 1 of each year.

(1) Number of resident workers (number of man hours per year)	40%
(2) Past production level (number of dozens exported)	20%
(3) Amount of money invested in machinery, vehicles, equipment, leasehold improvements	20%
(4) Entire company payroll	10%
(5) Company's Business Gross Revenue	10%

Example: If one company accounted for half of all the hours worked by resident workers employed by this industry, that company would receive one-half of all shares (21,000) available under category #1, or 10,500 shares (10,500 dozen). Likewise, if a company produced one half of the total number of sweaters exported by the industry from the Commonwealth in the last year, it would receive one-half of category #2, or 10% of the total of 70,000 dozen (7,000), and so on.

(c) If the allocation referred to in Section 5526(b) should result in decimal points in the final total, those decimal points shall be rounded off.

(d) The sources for the figures used to ascertain shares pursuant to Section 5526(b) shall be the following:

(1) For figures used in § 5526 (b) (1) - an employer created form reconciled with Employer's Income Tax Quarterly Withholding Return (Form: OS-3705, Rev. 3/85).

(2) For figures used in § 5526 (b) (2) - the Certificate of Origin for all sweaters exported.

(3) For figures used in § 5526 (b) (3) - List given to Attorney General during August, 1984; and other proof acceptable to the Director of Finance.

(4) For figures used in § 5526 (b) (4) - Employer's Income Tax Quarterly Withholding Return (Form: OS-3705, Rev. 3/85).

(5) For figures used in § 5526 (b) (5) - Business Gross Revenue Tax Quarterly Return (Form: OS-3105, Rev. 3/83).

(6) For figures used in § 5526 (b) (6) - Company lease agreement or building plans.

(7) Because reporting under this Act is monitored by the submission of quarterly reports and the report deadline is in the middle of the calendar year's last quarter, all applicants shall supplement their report for the months of

November and December of the previous year and October of the reporting year by using forms substantially similar to Forms 3105 and 2705 or a supplemental form to be provided by the Department of Finance for that purpose.

Section 5527. Increase of Waiver.

(a) The division of shares of any waiver in excess of the 70,000 dozen agreement, and the division of any increase, bonus or additional amount authorized by the federal government, shall be by the formula in Section 5526.

Section 5528. Retroactive Effect. The waiver certificates issued by the Director of Finance in June of 1985 shall be retroactive to November 1, 1984 and shall expire on October 31, 1985. All shipments already doumented by certificates of origin which entered the United States as part of the 70,000 dozen waiver shall be debited against the amounts of the certificate holders.

Section 5529. Tax Reduction. Because duty will have to be paid for all exports to Europe, Canada, New Zealand and Austrialia, the P.L. 4-14 user fee collected by the Chief of Customs for exports to those areas shall be limited annually for each garment factory to one percent of the first 50,000 dollars of exports to those areas; two percent for the next 50,000 dollars of exports to those areas; and three percent for every additional dollar of exports to those areas after the first 100,000 dollars of exports.

ARTICLE III. CERTIFICATION PROCESS

Section 5531. Commonwealth Imports.

(a) Imports of any component parts which come under an administrative agreement with the Government shall be identified as such to the Customs Division upon inspection.

(b) A company with a waiver certificate shall identify upon inspection the style of sweater to be assembled and shall provide the Customs inspector with a copy of a Customs ruling specifically issued to that company by the U.S. Customs Services, Department of Treasury, for assembly of that style or similar style.

(c) The Customs inspector shall inspect the component parts of each shipment and compare them with the components called for by the ruling. If the component is a more finished product than specified, the Customs inspector shall notify the Chief of Customs. The Chief shall not issue a certificate of origin or a sweater quota exemption certification for any sweater using the nonconforming component piece.

(d) All completed sweater samples shall be clearly and individually marked as samples. In addition, their container shall clearly indicate that samples are enclosed.

(e) The Chief of Customs shall cause records to be kept to identify imported component parts in exported finished sweaters.

Section 5532. Commonwealth Exports.

(a) A company seeking a sweater quota exemption certification shall apply to customs by executing under penalty of pejury an affidavit which states:

(1) the quantity of sweaters;

(2) the MFA category;

(3) the style number;

(4) the country of origin of the component part; and

(5) that each of the sweaters was assembled in the Northern Mariana Islands from a minimum of four separate major sweater panels.

(b) The Customs inspector shall check the shipment against the record of importation and shall stamp the front of the original commercial invoice in blue ink only if he reasonably believes the shipment qualifies under the certification agreement.

(c) The affidavit shall be kept in a file for that company with a deduction made from the company's share of waiver.

Section 5533. Perjury. In addition to criminal prosecution, the Chief of Customs may revoke a portion of a company's present or future quota if he finds, after an administrative hearing, proof by preponderance of the evidence of perjury in the affidavit submitted under Section 5532.

ARTICLE IV. CUSTOMS RECORDS

Section 5541. Signature Authority. By letter to the Director of Finance, the Chief of Customs shall designate four officials, including himself, who are authorized to issue and sign the certificates.

Section 5542. Certification Stamp. The Chief of Customs shall be responsible for the safe-keeping and use of the sweater quota exemption certification stamp.

Section 5543. Records.

(a) At the minimum, the Customs Division shall maintain the following records:

(1) importation of component parts listing quantities, style numbers, countries of origin, fiber, and recipient;

(2) affidavits upon exportation under the waiver;

(3) certificates of origin; and

(4) a current account of the remaining share of each company.

Section 5544. Inspection of Premises. Customs inspectors shall make periodic inspections of business premises, paying particular attention to:

(1) the processess of manufacturing;

(2) the component parts used;

(3) the number of resident workers and the types of tasks assigned; and

(4) the presence of any training programs for resident workers.

Section 5545. Audit. As a condition of accepting a waiver certificate, a company consents to provide the Public Auditor of the Northern Mariana Islands with access to and the right to examine and copy any records, data, or papers relevant to the manufacturing process in the Commonwealth.

Section 5546. Vacation of Regulations. Regulations published in the Vol. 7, No. 7 edition of the Commonwealth Register in 1985 which provide for distribution of Headnote 3A Production are vacated; Provided, that the allocation made by those regulations is effective until a new allocation is made under Section 5526 for November 1, 1985 - October 31, 1986.

Section 5547. Regulations. The Director of Finance or his designee may promulgate regulations to administer and enforce this act."

Section 2. Effective Date. This Act is effective upon approval by the Governor or upon becoming law without such approval.

Date: 8/13/85

PREFILED 8/7/85

Introduced by:

Rep. Juan T. Guerrero

Rep. Pedro T. Nakatsukasa

Rep. Pedro R. Guerrero

PUBLIC NOTICE

ADOPTED REGULATIONS

Providing for Distribution of Headnote 3(a) Production Under the Limited Waiver Provided by Administrative Arrangement.

The Director of Finance, under his customs authority, as provided by 1 CMC §§2553(1) and 2557, hereby adopts the June 6, 1985 rules and regulations which provide a distribution plan for manufacturers of the Headnote 3(a) limited waiver.

The changes in the May 21, 1985 proposed regulations are explained in the July 6, 1985 notice of proposed regulations.

These regulations, which are attached, shall take effect in 10 days following their publication.

Certified by: Tomas B.

TOMAS B. ALDAN
Director of Finance

7/19/85
Date

Filed this ________
June 19 85.
Office of Registrar of Corporations
Commonwealth of the Northern Mariana Islands

EMERGENCY and PROPOSED REGULATIONS
Providing for Distribution of Headnote 3(a) Production Under the Limited Waiver Provided by Administrative Arrangement.

Authority: The Director of Finance, under his customs authority as provided for by 1 CMC §§2553(i) and 2557, hereby promulgates emergency regulations and proposed regulations for subsequent adoption which provide a distribution plan for manufacturers of the Headnote 3(a) limited waiver.

Emergency: The Director of Finance hereby finds under 1 CMC §9105(b) that the public interest requires adoption of regulations providing a distribution plan for the limited waiver prior to providing public notice of thirty (30) days. This is necessary because the practical elimination of Headnote 3(a) manufacturing by Treasury Regulations (T.D. 84-171 and 85-38) in the Commonwealth of the Northern Mariana Islands has caused severe curtailment of production and the loss of numerous jobs to residents. An administrative arrangement with the United States government has lifted the restrictions imposed by the Treasury Regulations of 70,000 dozen sweaters. Production may commence and employment may be renewed as soon as this waiver is equitably distributed among Commonwealth manufacturers. These regulations provide for immediate distribution and shall remain in effect for one hundred and twenty (120) days or until adopted with or without amendments whichever occurs first.

Amendment of May 21, 1985 Regulations: These regulations are identical to the regulations proposed on May 21, 1985 with four (4) exceptions:

1. Number of Local Workers - section 202(a)(4) has been amended to allow for a gradual growth in local employment up to 40% to ensure proper training for local workers to assume skilled employment.
2. Date of Application - sections 202(b) and (c) have extended the application and award periods in order to provide sufficient notice of these amendments.
3. Surrender of Waiver - section 205 has been amended to require companies to surrender any anticipated unused portion of their share prior to the last quarter. Failure to do so may result in a loss of a portion of one's share in the subsequent year.
4. Import Inspection - section 301(b) has been amended to allow presentation of a Customs ruling for a similar style of sweater as well as for the same style.

Comment: Interested persons may submit in writing any data, views or arguments during the next thirty (30) days to the Director of Finance and the Attorney General. All comments will receive careful consideration prior to any action.

Certified by: Tomas B. Aldan
TOMAS B. ALDAN
Director of Finance

JUNE 06, 1985
DATE

Concurred by:
PEDRO P. TENORIO
Governor

June 6, 1985
DATE

June 6, 1985
Date of Filing with the Registrar

Acting
REGISTRAR OF CORPORATIONS

June 19__.
Office of Registrar of Corporations
Northern Mariana Islands

REGULATIONS PROVIDING FOR DISTRIBUTION OF HEADNOTE 3(a) PRODUCTION UNDER THE LIMITED WAIVER PROVIDED BY ADMINISTRATIVE ARRANGEMENT

ARTICLE I. GENERAL PROVISIONS

Section 101. Purpose. These regulations shall provide for a division among CNMI sweater manufacturers of the import limit placed by the United States upon cotton, wool and man-made fiber sweaters in Categories 345, 445, 446, 645 and 646 assembled in the CNMI from a minimum of four major sweater parcels which originate in a country whose sweater exports to the United States are subject to quota.

Section 102. Findings. The following administrative findings constitute the basis for these regulations:

(a) On January 9, 1978 upon the inception of the government of the Commonwealth of the Northern Mariana Islands General Headnote 3(a) to the Tariff Schedules of the United States, 19 U.S.C. 1202, provided a country of origin rule specifically for insular possessions of the United States. That rule provides that an article is a product of the insular possessions if it does not contain foreign materials exceeding 50% of the total appraisal value of the product. There are no quota restrictions or duties applicable to insular possessions.

(b) On February 22, 1983 the United States Customs Service recognized that Headnote 3(a) applied to the Commonwealth of the Northern Mariana Islands under Section 603(c) of the Covenant which provides the same treatment for imports from the Northern Mariana Islands into the United States as imports from Guam into the United States.

(c) Based upon that decision, certain corporations located sweater factories in the Commonwealth and began assembly operations under Headnote 3(a).

(d) On August 3, 1984 the Customs Service published interim regulations governing the importation of textiles and textile products into the United States (T.D. 84-171). These regulations, which applied to insular possessions, provide that articles which consist of materials which originated in a foreign country shall be considered as products of an insular possession only if the article has been substantially transformed by means of a substantial manufacturing or processing operation into a new and different article of commerce with a name, character or use distinct from the article or material from which it was so transferred. Essentially, assembly operations which contribute 50% to the final appraisal value of an article will no longer qualify the article as originating in the Commonwealth of the Northern Mariana Islands.

(e) As a result of the interim regulations, the sweater manufacturers have been unable to import sweaters into the United States Customs Territory, thereby threatening the existence of such an industry in the Commonwealth.

(f) On April 4, 1985 the Customs Service adopted the interim regulations, with minor amendments, as a final rule (T.D. 85-38).

(g) As a result of many months of discussion with the Committee for the Implementation of Textile Agreements (CITA) and the Office of the United States Trade Representative an administrative arrangement for the waiver of the regulations for 70,000 dozen sweaters annually was agreed to by the United States government and the government of the Northern Mariana Islands on January 30, 1985. A directive from the Chairman of CITA to the Commissioner of Customs establishes an import limit and certification requirements to be effective on April 15, 1985. However, the annual period commenced on November 1, 1984.

(h) The amount of the annual waiver was established by the United States as the annual production capacity of the sweater manufacturers which were engaged in manufacturing under Headnote 3(a) in the CNMI.

(i) It is necessary to establish a system for the distribution of the waiver among those factories.

ARTICLE II. WAIVER CERTIFICATE

Section 201. Waiver Certificate. The Chief of the Division of Customs shall issue a waiver certificate to applicants who meet the criteria set forth in Section 202 which will entitle the holder to a pro rata share of the waiver. The certificate shall specify the number of sweaters in the share.

Section 202. Eligibility for Certificate.

(a) An applicant is eligible for a waiver certificate upon proof of:

(1) incorporation in the Commonwealth of the Northern Mariana Islands prior to January 30, 1985;

(2) a valid license to conduct a sweater manufacturing business prior to January 30, 1985;

(3) CNMI certificates of origin evidencing production in excess of 7,500 dozen sweaters under Headnote 3(a) prior to January 30, 1985; and

(4) full time employment of workers in garment manufacturing operation who are either United States citizens, certificate of identity holders, Public Law

No. 5-11 permanent residents, or Trust Territory citizens who comprise the following percentages of the company's labor force:

(i) upon the effective date of this section - 20%;

(ii) within 90 days - 25%;

(iii) before January 1, 1986 - 30%; and

(iv) before January 1, 1987 - 40%.

(b) Application for a waiver certificate shall be made before June 8, 1985.

(c) Certificates shall be awarded prior to June 15, 1985.

(5) Failure to maintain this minimum requirement at any time during the year shall cause a certificate to be suspended until proof of compliance.

Section 203. Duration of Certificate. A waiver certificate shall be valid for one year. The Chief shall reissue certificates annually in October. The Director may amend the eligibility requirements in Section 202 in his discretion.

Section 204. Non-Assignable Certificates. Waiver certificates cannot be assigned, sold, or transferred by the holder to any other person or entity.

Section 205. Change in Pro Rata Shares.

(a) Upon any decrease in the amount of the waiver by the United States, the effect of the decrease shall be shared equally among each of the holders of waiver certificates, to the maximum extent practicable.

(b) If the Chief determines upon a hearing that a company cannot be reasonably expected to utilize its entire waiver within the year, the share of the company may be re-assigned in equal shares to the remaining companies which can reasonably be expected to utilize the remainder.

(c) If it appears to any certificate holder that the manufacturer will be unable to produce a sufficient number of sweaters in order to utilize its entire waiver within the year, the holder shall surrender to the Chief the expected remainder prior to August 1. If a company fails to utilize more than 10% of its waiver in a year, the unused portion shall be deducted from its share for the next year. Any surrendered remainders or deductions from shares shall be distributed pro rata among other certificate holders who can be reasonably expected to utilize the increase in their share.

Section 206. Retroactive Effect. The waiver certificates issued in June of 1985 shall be retroactive to November 1, 1984 and shall expire on October 31, 1985. All shipments already documented by certificates of origin which entered the United States as part of the 70,000 dozen waiver shall be debited against the amounts of the certificate holders.

Section 207. Increase of Waiver.

(a) The division of shares of any waiver in excess of the 70,000 dozen agreement shall not be by pro rata share.

(b) Such division shall ensure a continued commitment by manufacturers to the training and employment of resident workers. Resident workers are those described in Section 202(a)(4).

(c) To the pro rata share of each company of the increased waiver shall be added a percentage of the entire amount of the increased waiver for certain achievements which shall be subtracted equally from the other companies' shares. The achievements of each company shall be assessed by the Chief of Customs in consultation with the Director of Commerce and Labor looking at the company's performance over the year. The achievements and percentages are:

(1) for the company which employs the most resident workers (the number of man hours per year) . . . 5%

(2) for the company which has paid the most total salary for resident workers over a year . . . 5%

(3) for the company which has provided the best quality training program over a year 5%

(4) for the company which has placed resident workers in more different positions in stages of production and management 5%

Example: If there are three companies eligible and the waiver is increased to 130,000 dozen, if one company received all the awards, then it would be entitled to 23,333 dozen (base pro rata share of 70,000 dozen) plus 20,000 (base pro rata share of 60,000 increase) plus 12,000 (20% of the 60,000 increase). The other companies would receive 23,333 plus 14,000 dozen each.

ARTICLE III. CERTIFICATION PROCESS

Section 301. Commonwealth Imports.

(a) Imports of any component parts which come under the administrative agreement must be identified as such to Customs upon inspection.

(b) A company with a waiver certificate shall identify upon inspection the style of sweater to be assembled and shall provide the Customs inspector with a copy of a Customs ruling for assembly of that style or a similar style.

(c) The Customs inspector shall inspect the component parts of each shipment and compare them with the components called for by the ruling. If the component is a more finished product than specified, the Customs inspector shall notify the Chief of Customs. The Chief shall not issue a certificate of origin or a sweater quota exemption certification for any sweater utilizing the nonconforming component piece.

(d) All completed sweater samples shall be clearly and individually marked as samples. In addition, their container shall clearly indicate that samples are enclosed.

(e) The Chief of Customs shall cause records to be kept to identify imported component parts in exported finished sweaters.

Section 302. Commonwealth Exports.

(a) A company seeking a sweater quota exemption certification shall apply to Customs by executing under penalty of perjury an affidavit which states:

(1) the quantity of sweaters;

(2) the MFA category;

(3) the style number;

(4) the country of origin of the component part; and

(5) that each of the sweaters was assembled in the Northern Mariana Islands from a minimum of four separate major sweater panels.

(b) The Customs inspector shall check the shipment against the record of importation and shall stamp the front of the original commercial invoice in blue ink only if he reasonably believes the shipment qualifies under the certification agreement.

(c) The affidavit shall be kept in a file for that company with a deduction made from the company's share of the waiver.

Section 303. Perjury. In addition to criminal prosecution, the Chief of Customs may revoke a portion of a company's present or future quota if he finds, after an administrative hearing, proof by a preponderance of the evidence of perjury in the affidavit submitted under Section 302.

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ARTICLE IV. CUSTOMS RECORDS

Section 401. Signature Authority. The Chief of Customs shall designate by letter to the Director of Finance four officials, including himself, authorized to issue and sign the certificates.

Section 402. Certification Stamp. The Chief of Customs shall be responsible for the security of the sweater quota exemption certification stamp.

Section 403. Records.

(a) At the minimum, the following records must be maintained by the Customs Division:

(1) importation of component parts listing quantities, style numbers, countries of origin, fiber, and recipient;

(2) affidavits upon exportation under the waiver;

(3) certificates of origin; and

(4) a current account of the remaining share of each company.

Section 404. Inspection of Premises. Customs inspectors shall make periodic inspections of business premises, paying particular attention to:

(1) the processes of manufacturing;

(2) the component parts utilized;

(3) the number of resident workers and the types of tasks assigned, and

(4) the presence of any training programs for resident workers.

Section 405. Audit. As a condition of accepting a waiver certificate, a company consents to provide the Public Auditor of the Commonwealth of the Northern Mariana Islands with access to and the right to examine and copy any records, data, or papers relevant to the manufacturing process in the Commonwealth.

CHAPTER 4.
Nonresident Workers Act.

Article 1. General.

§4411. Nonresident Workers: Policy.
§4412. --Definitions.
§4413. --Preference for Resident Workers.

§4411. Nonresident Workers: Policy. The Legislature finds and declares that it is essential to a balanced and stable economy in the Commonwealth that residents be given preference in employment and that any necessary employment of nonresident workers in the Commonwealth not impair the wages and working conditions of resident workers.

The Legislature recognizes the need for alien labor at the present state of economic development but finds that the employment of nonresident workers should be temporary and generally limited to the duration of the specific job or employment for which the alien was recruited.

The Legislature finds that specific data regarding job category needs, availability of resident labor in particular employment categories, and impact of apprentice training programs, is currently minimal. It is the Legislature's intent that the implementation of this Chapter will generate reliable data upon which more specific alien labor policies can be developed.

Source: PL 3-66, §2.

Commission Comment: In enacting Public Law 3-66, the "Nonresident Workers Act," effective August 18, 1983, the Legislature expressly repealed Title 49 of the Trust Territory Code. (PL 3-66, §§1, 20, 22).

§4412. Nonresident Workers: Definitions. As used in this Chapter, the term:

(a) "Agreement" means a non-resident employment agreement between the Chief of Labor and an employer pursuant to Section 4433;

(b) "Available" means offering to perform any type of services or labor for an employer at the time and place, and under the terms and conditions, designated by such employer;

(c) "Certificate" means a certificate of labor and immigration issuable by the Director pursuant to Section 4435(b);

(d) "Chief" means the Chief of Labor;

(e) "Contract" means a contract between a non-resident worker and an employer, pursuant to Section 4434;

(f) "Director" means the Director of Commerce and Labor;

(g) "Division" means the Division of Labor of the Department of Commerce and Labor;

(h) "Employer" means any individual, partnership, association, or corporation hiring, employing, or otherwise engaging for compensation any resident worker or nonresident worker to perform services or labor within the Commonwealth, including any branch, agency, or instrumentality of the Commonwealth, but does not include the Trust Territory of the Pacific Islands or United States government;

(i) "Nonresident worker" means any available individual who is at least 18 years old and who is capable of performing services or labor desired by an employer and who is not a resident worker. Nonresident worker shall not include any foreign investor, professional, or executive; and

(j) "Resident worker" means any available individual who is capable of performing services or labor desired by an employer, and who is a citizen or national of the United States as defined in the Constitution of the Northern Mariana Islands or who has been granted national or citizenship status pursuant to Commonwealth law or who is legally residing without restrictions as to employment in the Commonwealth.

Source: PL 3-66, §3.

§4413. Nonresident Workers: Preference for Resident Workers.

Resident workers shall be given preference in employment in the Commonwealth. Nonresident workers shall be employed only as necessary to supplement the available labor force. No employer shall hire, employ, or otherwise engage for compensation any nonresident worker to perform services or labor in the Commonwealth except in strict accordance with the provisions of this Chapter and any rule or regulation issued under this Chapter.

Source: PL 3-66, §3.

Article 2. Administrative Provisions.

§4421. Chief of Labor: Functions and Duties.
§4422. Apprenticeship Training Program.
§4423. Federal Grants and Programs.
§4424. Rules and Regulations.
§4425. Annual Report.

§4421. Chief of Labor: Functions and Duties.

For the purposes of this Chapter, and without limitation on the scope or extent of powers, duties, and responsibilities vested by any other provision of law, the Chief shall, under the supervision of the Director, have the following functions and duties:

(a) Establish and maintain a system of registration, referral, and other employment services to assist potential resident workers in obtaining employment and assist employers in locating resident workers.

(b) Conduct continuing surveys of manpower needs, prepare training programs, and establish or recommend other methods for alleviating shortages of resident workers and reducing the need for nonresident workers.

(c) Oversee, monitor, and review the use of nonresident workers and all matters related to such use, including the health, safety, meals, lodging, salaries, and working hours and conditions of such workers, and the specific contractual provisions for the services or labor of such workers.

(d) Enforce, pursuant to Sections 4441-4446, the provisions of this Chapter and any agreement which the Chief enters into with any employer concerning the employment of nonresident workers.

(e) Require that employers accept such agreement or conditions for the payment of wages or benefits to nonresident workers, or any other agreement or contract provision, as the Chief determines to be necessary and consistent with the policy and purposes of this Chapter, and any such agreement, condition, or provision shall be legally enforceable in the courts of the Commonwealth.

(f) Establish occupational categories, minimum standards of qualification, and procedures for certification of nonresident workers.

Source: PL 3-66, §5.

§4422. Apprenticeship Training Program.

Not later than 150 days after the date of enactment of this Chapter, the Chief, with the approval of the Director, shall transmit to the Governor a plan for an apprenticeship training program for resident workers, in which employers would be reimbursed for a portion of the wages or salaries of apprentices during a period of training designed to qualify them at the journeyman level of a trade or entry level of a profession. This program shall be limited to trades which the Chief finds to be essential to the future development needs of the Commonwealth or where significant numbers of nonresident workers are employed. In developing this program, the Chief shall give special consideration to the need for trained resident workers in the fields of construction, agriculture, home economics, fisheries, hotel management and tourism services, mechanics, and business trades. This plan shall include an estimate of funds necessary to implement this program for the Fiscal Year ending September 30, 1984 and an estimate of any Federal or other grant which may be available for such implementation. The Chief shall implement this plan and administer this program, subject to the availability of funds.

Source: PL 3-66, §11.

§4423. Federal Grants and Programs.
The Chief shall develop a list of all labor programs and services offered to State or local governments, employers, or individuals by the United States Department of Labor or any other agency or instrumentality of the United States, together with a statement regarding the eligibility of the Commonwealth for participation in such programs and receipt of such services, and the appropriateness of such programs and services to the Commonwealth. This list and statement shall be included in the annual report of the Division transmitted pursuant to Section 4447.

Source: PL 3-66, §12.

§4424. Rules and Regulations.
The Director shall promulgate rules and regulations to implement the provisions of this Chapter pursuant to the Administrative Procedure Act (commencing at Section 9101 of Title 1 of this Code). These regulations may include the imposition of reasonable fees for services rendered by the Division, except that no fee may be charged for the registration or referral of any resident worker. Any fee collected pursuant to this Section shall be transmitted to the Commonwealth Treasury for credit to the General Fund. The Director may delegate any function or duty of the Chief under this Chapter to the Attorney General or to the Director of Public Health and Environmental Services.

Source: PL 3-66, §13.

§4425. Annual Report.
Within 120 days of the end of the government fiscal year, the Chief shall prepare an annual report of the operations and activities of the Division during the year. The report shall include data regarding the number of nonresident workers employed in the Commonwealth during the year, the citizenship

and point of hire of workers, the occupational categories or job titles filled by the workers, the number of accompanying family members, wage scales, and any other information regarding nonresident workers as may be appropriate. The report shall also include information regarding registration and referral of resident workers, the apprenticeship training program, and the list and statement regarding federal grants and programs required to be included in the report pursuant to Section 4422. The report shall be transmitted through the Director to the Governor and to the presiding officer of each House of the Legislature and shall be public information.

Source: PL 3-66, §17.

Article 3. Procedural Requirements.

§4431. Procedures and Requirements: Employer Notifies Chief.
§4432. --30-Day Advertising.
§4433. --Nonresident Employment Agreement.
§4434. --Approval of Contract by Director.
§4435. --After Contract Approved.
§4436. Transfer of Employment.
§4437. Restrictions and Obligations.
§4438. Health Certification.
§4439. Required Records.
§4440. Exemptions.

§4431. Procedures and Requirements: Employer Notifies Chief.

Any employer who desires to utilize the services of the Division in locating resident workers to fill job vacancies or, if resident workers cannot be located, obtain permission to employ nonresident workers, shall notify the Chief and report such vacancies, stating the place and nature of the employer's business, the number of workers desired, the occupational qualifications of these workers, the wages to be paid the workers, the date on which it is desired that employment commence, the island or islands on which the workers are desired, and any other information the Chief may require or which the employer may deem appropriate. The Chief may require the employer to justify any occupational qualification as appropriate to the nature of the position.

Source: PL 3-66, §6(a).

§4432. Procedures and Requirements: 30-Day Advertising.

Upon receipt of notification pursuant to Section 4431, the Chief shall first endeavor to fill the job vacancies reported by the employer by referral of resident workers registered with the Division. In the event of inability to supply sufficient resident workers by such referral, the Chief shall cause the existence of the vacancies and other applicable information regarding the jobs to be publicized. This publication shall include notice to all offices of the Department of Commerce and Labor, posting of notice in public places in the Commonwealth, advertising in a newspaper of general circulation in the Commonwealth, the use of the public media when appropriate, and any other means as the Chief may determine to be feasible. This publication shall continue for a period of 30 days, except that the Director may waive all or part of this period if he finds that a waiver is in the public interest and not inconsistent with the policy of this Chapter.

Source: PL 3-66, §6(b).

§4433. Procedures and Requirements: Nonresident Employment Agreement.

Not later than seven days after the date of expiration of the period of publication required pursuant to Section 4432, upon a finding by the Chief that there is no resident worker to fill any job vacancy announced in this publication, the Chief shall determine under what conditions and for what period of time the employer shall be permitted to use a nonresident worker to fill the vacancy. If the employer desires to use a nonresident worker under these conditions, the employer shall enter into a nonresident employment agreement with the Chief to this effect. This agreement may apply to more than one vacancy, as the Chief may, in his discretion decide, and shall include, in addition to any other provision the Chief deems necessary, the following provisions:

(a) A statement that the employer requires one or more nonresident workers commencing on or about a stated date to perform services or labor on a stated island or islands;

(b) A statement of any occupational category or job title covered by the agreement and any qualification which must be met by any nonresident worker employed pursuant to the agreement;

(c) A statement of the wages the employer is paying or intends to pay each nonresident worker for each vacancy, occupational category, or job title covered by the agreement;

(d) A statement that the employer agrees to comply with the conditions stated in the agreement, the minimum employment conditions and other requirements applicable to such workers pursuant to this Chapter, and any other applicable provision of law including a specific consent to entry pursuant to Section 4442.

(e) A statement of the period of time for which the employer will be allowed to fill any position with a nonresident worker before the employer must attempt to locate a resident worker for the position by again complying with the provisions of this section;

(f) A statement that any contract offered to a nonresident worker pursuant to the agreement shall be contingent upon approval by the Chief:

(g) A copy of a draft nonresident employment contract in a form, containing provisions including occupational category or job title, term of employment, location of work, work schedule, wage scale for regular and overtime work, and any deductions from pay, as may be required by law. In lieu of this copy, a statement that an acceptable previously filed or prescribed contract form may be used; and

(h) A statement that the employer will secure a bond or other surety for each nonresident worker as provided in Section 4435(a).

Source: PL 3-66, §6(c).

§4434. Procedures and Requirements: Approval of Contract by Director.

After entering into a nonresident employment agreement pursuant to Section 4433, an employer may use a nonresident worker to fill the job vacancy covered by this agreement, subject to the following procedures and conditions:

(a) Prior to the entry of the nonresident worker into the Commonwealth for employment under the provisions of this Chapter or, if the worker is already within the Commonwealth, prior to commencing employment, the employer shall present to the Chief the affidavit described in subdivision (b), a fully executed employment contract between the employer and the nonresident worker which shall be contingent on approval by the Chief, any required fee, and any other information or document required pursuant to this Chapter or pursuant to the employment agreement.

(b) The affidavit of the nonresident worker shall be sworn to by the worker and shall indicate--

(1) That the worker has a minimum of two years experience in the occupational field for which he or she is to be hired, except that two years total experience in any field shall suffice if the position is an unskilled position as designated by the Chief;

(2) That the worker meets any occupational qualification for the position as published in the vacancy announcement required by subdivision (b) of this section;

(3) The marital status of the worker, and the name, address, age, and relationship of any dependent; and

(4) That the worker has not been convicted of a felony or other crime involving moral turpitude, except that the Director may waive this requirement if the Director finds that the presence of the worker in the Commonwealth would not be detrimental to the public interest.

(c) After reviewing the information and documents submitted pursuant to subdivision (a) and within 30 calendar days of its receipt the Chief shall determine if the nonresident worker and the employment contract meet all the requirements of this Chapter. If the nonresident worker does not qualify, the Chief shall notify the employer and the nonresident worker if the worker is within the Commonwealth, giving reasons for this determination in writing. If the employment contract is not in compliance, the Chief shall prepare a corrective addendum to be executed by the employer and the nonresident worker. When the Chief is satisfied that all requirements have been met, he shall signify his approval on the employment contract and any addendum and notify the employer.

Source: PL 3-66, §6(d)(1)-(3).

§4435. Procedures and Requirements: After Contract Approved.

(a) After receiving notice from the Chief that an employment contract has been approved, the employer shall deliver to the Chief a bond or other surety from a recognized insurance company in an amount and form acceptable to the Chief to secure the faithful performance of the duties and responsibilities of the employer and the departure of the nonresident worker at the end of his period of employment.

(b) The Director and the Attorney General shall provide for a certificate to be used for both labor and immigration purposes. After receiving evidence of the bond or surety pursuant to subdivision (a) and after receiving any required fee, the Director shall within 30 calendar days issue such certificate and forward it to immigration authorities for such immigration clearance as may be required by law. This certificate shall include:

(1) The name of the nonresident worker,

(2) The name of his or her employer,

(3) The occupational category or job title,

(4) The nonresident worker's legal residence,

(5) The nonresident worker's citizenship,

(6) The date of expiration of the certificate, and

(7) The number of the nonresident employment agreement under which the worker is employed.

The nonresident worker shall keep a copy of this certificate on his person, or otherwise readily available at all times.

(c) No later than 30 calendar days after receipt of the Director's certificate, the Commonwealth Immigration authority shall issue the appropriate entry documents or indicate specifically in writing its reasons for denying entry documents and transmit such denial to the Director, and the employer.

Source: PL 3-66, §6(d)(4)-(6).

§4436. Transfer of Employment.

(a) A non-resident worker may transfer from one employer to another or one job to another subject to approval by the Chief pursuant to regulation.

(b) The Director shall promulgate regulations for non-resident worker job or employer transfer. Such regulations shall include but not be limited to:

(1) Requirement of a $200 transfer fee by the employer regardless of whether transfer is from one job to another for the same employer, or between employers;

(2) A requirement of compliance by the non-resident worker with all provisions of this Chapter applicable to his or her prior employment.

(c) The transfer regulations promulgated pursuant to subdivision (b) may include occupational categories ineligible for transfer and such other provisions as the Director may reasonably deem necessary to implement the purposes of this Chapter.

(d) Upon written application of an employer or non-resident worker the Chief shall approve or deny the transfer within 14 working days.

(1) If the transfer is denied the employer and worker shall be advised of the denial in writing. This advisement shall include the cause of denying transfer.

(2) If the transfer is approved the Chief shall renew the certificate and transmit a copy thereof to the immigration authorities, along with any pertinent change in the worker's status, pursuant to Section 4435(b).

(3) Upon receipt of a renewed certificate the immigration authority shall renew or reissue the appropriate entry documents pursuant to Section 4435(c).

(e) Nothing under this Chapter including issuance of an initial certificate shall give rise to any presumption in favor of or claim of right to transfer.

Source: PL 3-11, §7.

§4437. Restrictions and Obligations.

(a) No employment contract, or nonresident employment agreement, registration, certification or permit, or the presence of an alien within the Commonwealth pursuant thereto shall be grounds for naturalization or citizenship, or permanent residency except as may be otherwise provided by law.

(b) Any nonresident worker and accompanying family members shall depart the Commonwealth to their nation of origin within 20 days after the expiration or other termination of the employment of the worker under this Chapter;

(1) If the nonresident worker has filed a complaint against his or her employer with the Chief pursuant to Section 4444, or has filed a lawsuit against his or her employer pursuant to Section 4447(b), he or she shall be permitted to remain within the Commonwealth for a reasonable time to permit his or her complaint to be reduced to judgment. Such a nonresident worker shall be permitted to continue working within the Commonwealth on a temporary basis during the pendency of the complaint by an appropriate order of the Chief of the Division of Labor or of the Court unless it is shown that such employment will seriously prejudice the Commonwealth.

(2) If a transfer application pursuant to Section 4436 has been filed with the Director, a non-resident worker shall be permitted to remain in the Commonwealth for a period of 90 days.

(c) No nonresident worker employed pursuant to this Chapter shall be paid less than any minimum wage applicable to the occupational category or job title of the worker and provided by law. Any employment contract under this Chapter shall provide that any future increase in the applicable minimum wage prior to the expiration of the term of the contract shall apply to work performed under the contract on or after the effective date of the increase. Any period of time during which the worker is required to be present at any location within the Commonwealth designated by his or her employer shall be considered working hours for purposes of determining wages and overtime pay.

(d) All nonresident employment contracts under this Chapter shall provide that the employer is responsible and liable for the insurance or payment of all medical expenses of the nonresident worker, including cost of referral and evacuation for medical treatment outside the Commonwealth, and cost of the embalming and transportation of the body back to the country of origin in the event of death of the nonresident worker.

(e) No employer or nonresident worker shall execute any contract, make any other agreement, or change any existing contract, in writing or otherwise, regarding the employment of such worker, without the approval of the Chief, and no nonresident worker shall perform labor or services within the Commonwealth except pursuant to an approved contract or an approved change to this contract. Any non-resident employment contract or change thereto which has not been approved by the Chief or which violates any provisions of this act shall in the discretion of the Chief:

(1) Be voidable

(2) Be grounds for certificate revocation

(3) Be grounds to disqualify an employer from further use of any non-resident labor.

(f) No nonresident worker shall perform services or labor within the Commonwealth for any employer other than the employer for whom the Chief has approved an employment contract with such worker, except pursuant to Section 4436.

(g) Each employer shall give to any nonresident worker within his or her employ a copy of the approved employment contract with the worker, and no employer shall withhold from a worker any identification certificate, passport, entry permit, or other document related to the status of the worker.

(h) A nonresident worker shall not be required to leave the Commonwealth to maintain certification, to renew certification or transfer employment pursuant to Section 4436.

Source: PL 3-66, §8.

§4438. Health Certification.

(a) Any nonresident worker admitted to the Commonwealth for employment under the provisions of this Chapter, or any person admitted as a member of the family of such worker, shall have in his possession a certificate of freedom from communicable disease. This certificate shall have been executed not more than 30 days preceding the date of entry into the Commonwealth by a physician licensed to practice medicine in the jurisdiction of issue.

(b) Within 10 working days of initial entry into the Commonwealth of a nonresident worker for employment under this Chapter or, if the worker is already present in the Commonwealth for some other purpose, within 10 working days after the Chief issues a nonresident worker identification certificate for the worker, the worker shall present himself, together with any accompanying family member, for physical examination by or under the auspices of the Department of Public Health and Environmental Services at a time and place as the Department may designate for the examination. Any family member preceding or following the worker to the Commonwealth shall appear for an examination within 10 working days after entry into the Commonwealth. The cost of any examination of a nonresident worker shall be borne by the employer. The cost of any examination of a member of the family of any nonresident worker shall be borne by either the worker or the employer, as the employment contract shall provide. The Chief shall by regulation provide for annual physical examination of nonresident workers and family members when employment under this Chapter will continue for more than one year. The cost of all examinations under this Section shall reflect the total cost of providing the examinations.

(c) Any person subject to a physical examination pursuant to subdivision (b) shall surrender his or her certificate of freedom from communicable disease to the examining physician or other designated person at the time of the examination. Within 10 working days after the examination, the Director of Public Health and Environmental Services shall transmit the certificate to the Chief through the Director, together with findings as to whether there is any medical reason that the person should not be permitted to remain in the Commonwealth under this Chapter. This finding shall be based on the medical probability that any disease, whether or not communicable, any disability, or any other medical matter, would result in significant danger to the health of the inhabitants of the Commonwealth or in the need for prolonged medical care or treatment while in the Commonwealth .

(d) Upon receiving notice that there is any medical reason that any nonresident worker or family member should not be permitted to remain in the Commonwealth, the Chief shall notify the employer and the nonresident worker, or family member, and the affected person shall immediately surrender his or her certificate to the Chief for appropriate action. The Chief shall transmit a copy of all pertinent documents through the Director to the Attorney General for immigration control, and the employer shall make arrangements for the affected person to depart the Commonwealth. This departure shall take place at the earliest possible time that it is medically safe for the affected worker to travel.

Source: PL 3-66, §9.

§4439. Required Records.

Any employer of any nonresident worker shall keep and present immediately upon demand of the Chief or his authorized representative, and at such regular intervals as the Chief may by regulation require, the following information:

(a) The name, address, age, domicile, citizenship, point of hire, and contract expiration date of each worker;

(b) The occupational category or job title, and the wage rate or salary, of each worker;

(c) Payrolls showing the number of hours worked each week, gross compensation, any deduction, and net payments made to each worker;

(d) The number of employment-related accidents to nonresident workers, the name of any injured worker, type of injury, treatment, amount of time lost from work, and whether hospitalization was required; and

(e) The number of illnesses of nonresident workers, whether or not employment-related, causing time to be lost from work, the name of any such worker, type of illness, treatment, amount of time lost from work, and whether hospitalization was required.

Source: PL 3-66, §10.

§4440. Exemptions.

(a) The Chief with the approval of the Director may authorize exemptions from the following Sections or parts thereof of this Chapter: 4431, 4432, 4433(g), 4433(h), 4434(c), 4435(a), 4437(c) and 4439(a)-(c). These exemptions shall be specifically enumerated in an exemption employer agreement and may be granted to an individual employer for a particular project described in the agreement. Non-resident workers entering the Commonwealth pursuant to an exemption agreement shall not be permitted to transfer to another employer or project and shall depart the Commonwealth within 20 days of completion of their work. No family members or relatives may be permitted to accompany workers entering pursuant to an exemption.

(b) This Chapter shall not apply to any person who represents a foreign government in the Commonwealth in a diplomatic, consular, or similar official capacity, or assists in such representation, as certified by the Governor; provided, that the person does not perform any proprietary or commercial activity for which a business license or permit is required by law.

(c) This Chapter does not apply to any person who qualifies as a holder of a Certificate of Foreign Investment issued by the Director of Commerce and Labor.

Source: PL 3-66, §16.

Article 4. Enforcement Provisions.

§4441. Enforcement: Investigations.
§4442. --Authority to Enter.
§4443. --Personnel Support.
§4444. --Administrative Hearing.
§4445. --Administrative Review.
§4446. --Judicial Review.
§4447. Remedies and Penalties.

§4441. Enforcement: Investigations.

The Chief or his designee shall conduct investigations as the Chief may deem appropriate and necessary to enforce this Chapter, rules or regulations promulgated hereunder, or agreements or contracts entered pursuant hereto, or any injury to a non-resident worker, or working conditions, or employer-provided housing conditions; the Chief shall investigate and report in writing to the Director and Attorney General any death or injury of a non-resident worker which results in substantial physical or mental impairment.

Source: PL 3-66, §14(a).

§4442. Enforcement: Authority to Enter.

The Chief or his designee may enter any worksite where non-resident workers are employed, or any non-resident worker employer-provided residential facility. Such entry may be at any time work is in progress, or any other reasonable time, and may be for general inspection purposes or in furtherance of a specific investigation. As a condition of and in consideration of any approval to employ non-resident workers pursuant to this Chapter any employer is deemed to agree to entry pursuant to this Section, and no warrant shall be required. Refusal to permit such entry shall be a violation of this Chapter.

Source: PL 3-66, §14(b).

§4443. Enforcement: Personnel Support.
For purposes of carrying out responsibilities pursuant to this article. the Chief, with approval of the Director, may by agreement with another agency of the Commonwealth utilize with or without reimbursement the services, personnel, or facilities of the agency.

Source: PL 3-66, §14(c).

§4444. Enforcement: Administrative Hearing.

(a) If upon an investigation pursuant to Section 4441 the Chief has reason to believe that any provision of this Chapter, or rule or regulation promulgated pursuant hereto, or any agreement or contract entered hereunder, has been or is being violated the Chief shall within 10 days either:

(1) Issue a warning and request to correct the violation to the alleged violator, or

(2) Issue a Notice of Violation and conduct a hearing pursuant to Section 9109 of Title 1 of this Code.

(3) When the Chief has elected to issue a warning and request to correct and the alleged violator has not complied within 10 days the Director shall immediately issue a Notice of Violation and conduct a hearing pursuant to Section 9109 of Title 1 of this Code.

(b) For purposes of hearings conducted pursuant to this Section 4444 and for purposes of Sections 9109 and 9110 of Title 1 of this Code:

(1) "Agency" shall mean the Chief or such hearing officer as may be appointed by the Director, and

(2) The agency shall have general power to issue subpenas, summon witnesses, require production of books, papers, documents and records, administer

oaths, and such other powers as may be necessary to effectively implement this Chapter.

(c) All hearings shall be commenced within 30 days of the issuance of the Notice of Violation. Notwithstanding any other provision of law, hearings may be public or closed at the discretion of the agency. Adequate notice shall be given to all parties and opportunity shall be made available to them to present such evidence as they may desire.

(d) The agency shall upon concluding the hearing issue findings, decisions and orders within 10 days. Issuance of findings, orders and decisions upon hearing shall be pursuant to Section 9110 of Title 1 of this Code, but shall not be judicially reviewable until final.

(e) In addition to such sanctions, orders and relief that may be elsewhere authorized the agency may:

(1) Cancel or modify a non-resident worker certificate;

(2) Cancel or modify a non-resident employment agreement;

(3) Cancel or modify a non-resident worker contract;

(4) Temporarily or permanently disqualify an employer from using any non-resident labor;

(5) Transfer an affected non-resident worker to another employer with the consent of the worker and new employer. Section 4436 does not apply to such transfer;

(6) Impose such other sanction, order or relief that may reasonably give effect to the purposes and provisions of this Chapter.

(f) The Chief shall immediately notify the immigration authority of any cancellation or modification of a non-resident worker labor and immigration certificate.

Source: PL 3-66, §14(d).

§4445. Enforcement: Administrative Review.

(a) Within 15 days of issuance any person or party affected by findings, orders or decisions of the agency made pursuant to Section 4444 may appeal to the Director by written notice. If no appeal is made to the Director within 15 days of issuance of the original findings, orders or decisions shall be unreviewable administratively or judicially.

(b) Upon review the Director may, at the Director's discretion:

(1) Restrict review to the existing record;

(2) Supplement the record with new evidence;

(3) Hear oral argument;

(4) Hear the matter de novo in which case the hearing shall be conducted pursuant to Sections 9109 and 9110 off title 1 of this Code.

(c) Upon completion of review the Director shall confirm or modify the agency findings, order or decision in writing within 10 days. Any modification shall include supplemental findings. The Director's decision shall constitute final action for purposes of judicial review.

Source: PL 3-66, §14(e).

§4446. Enforcement: Judicial Review.
Judicial review of a final action of the Director is authorized after exhaustion of administrative remedies, and must be initiated within 15 days of the final action. Except as may be contrary to the provisions of this Chapter, judicial review shall be pursuant to Section 9112 of Title 1 of this Code. Notwithstanding any other provision of law however:

(a) Notice of all actions and proceedings pursuant to this Section shall be served on the Attorney General, and

(b) Judicial review shall be confined to the record.

Source: PL 3-66, §14(f).

§4447. Remedies and Penalties.

(a) At the request of the Director, or of the Chief through and with the approval of the Director, the Attorney General may institute a civil action in any court of record having jurisdiction for a temporary restraining order, injunction, or other appropriate remedy to enforce any provision of this Chapter, or any rule, regulation, or order issued under this Chapter.

(b) Any nonresident worker who is aggrieved by the failure or refusal of his employer to comply with the employment contract approved under this Chapter with respect to the worker may make a complaint to the Chief who shall conduct an investigation pursuant to Section 4441. In addition to such other remedies as may exist the Chief may, with the approval of the Director and Attorney General, institute an action on behalf of the worker. In any action taken by the Chief on behalf of an aggrieved nonresident worker, the Chief shall be represented by the Attorney General. Nothing in this Chapter shall preclude any private redress or right of action otherwise available to a nonresident worker.

(c) If any person fails to comply with any provision of this Chapter, or any rule, regulation, or order issued under this Chapter, or any nonresident employment agreement, after notice of such failure and expiration of any reasonable period allowed by the Chief for corrective action, the person shall be liable for a civil penalty of not more than $500 for each day of the continuance of such failure. Subject to the approval of the Director, the Chief may assess, collect, and compromise any such penalty. No penalty shall be assessed until the person charged with a violation has been given an opportunity for a hearing pursuant to Section 4444.

(d) In any action taken directly by, or on behalf of a non-resident worker notwithstanding any other remedies that may apply, the worker shall recover unpaid wages and overtime compensation, an additional equal amount as liquidated damages, court costs and reasonable attorney fees. However attorney fees shall not be recoverable against the Commonwealth.

(e) Any person who violates any provision of this Chapter or any regulation or order issued under this Chapter, or who makes any false statement to the Chief or his authorized representative, or to the Director, during the course of any investigation, hearing, or other proceeding under this Chapter, shall, upon conviction, be punished by a fine of not more than $5,000 or by imprisonment for not more than one year or both.

Source: PL 3-66, §15.

Article 5. Other Provisions.

§4451. Transition.
§4452. Authorization of Appropriations.

§4451. Transition.

Any employer using non-resident workers in the Commonwealth, and any non-resident worker within the Commonwealth, at the effective date of this Chapter shall within one year comply fully with all provisions of this Chapter, provided that no transfer or employer-worker contract or contract modification, extension, or renewal shall be permitted except in full compliance with this Chapter. The provisions of Sections 4437(g), 4441 et seq., and 4447 apply to all employers and workers upon the effective date of this Chapter.

Source: PL 3-66, §19.

Commission Comment: This Chapter became effective on August 18, 1983.

§4452. Authorization of Appropriations.
There is hereby authorized to be appropriated such sums as may be necessary to carry out the provisions of this Chapter.

Source: PL 3-66, §18.

Mr. **Pease**. Thank you very much, Mr. Tenorio. We appreciate your testimony.

Does that complete the testimony of this panel?

Mr. **Blaz**. Yes, it does, Mr. Chairman.

Mr. **Pease**. At this time then I would like to——

Mr. **Harrison**. Excuse me, Mr. Chairman. My name is Donald Harrison. I am here on behalf of the American Fiber Textile Apparel Coalition.

Mr. **Pease**. Are you testifying in opposition to the legislation?

Mr. **Harrison**. We wanted to express the concern of the domestic——

Mr. **Pease**. All right, we will recognize you next. We want to take care of this panel. You are on the next panel so we will get to you. OK?

Mr. **Harrison**. Thank you, Mr. Chairman.

Mr. **Pease**. Let me recognize now Mr. Frenzel, who is the author of this bill, for any questions he might have.

Mr. **Frenzel**. Thank you very much, Mr. Chairman. I am sorry to interrupt Mr. Harrison. I have got to leave and the chairman is being generous in giving me some time at the moment.

I want to thank this panel of witnesses and particularly Lieutenant Governor Reyes, who has come a long way to make a statement that some of us—despite Mr. Blaz's theory that none of us know where the Pacific is—that some of us have flown that far and know that it is no small chore for both of you lieutenant governors to have come all this distance. We appreciate you doing that to advise us.

Congressman Blaz, as I understood it, what you are trying to do is to protect some American industry which is resident on the island of Guam, employing Americans who are resident on the island of Guam in this particular operation. Is that correct?

Mr. **Blaz**. Absolutely correct, Mr. Frenzel.

Mr. **Frenzel**. You are not changing quotas or asking for remission of quotas; you are simply trying to protect that 300-man operation from the country-of-origin change?

Mr. **Blaz**. That is correct.

Mr. **Frenzel**. I think one of the things that you have lectured to us on incessantly is that we are not talking about some kind of foreign country and that these employees are all Americans and they are our countrymen and that we have particular responsibilities to them and that when we change the rules to protect Americans who are resident on the mainland we have to be very careful that we don't disrupt the employment opportunities for Americans who happen to be resident on the island of Guam.

As I understand it, that is all your bill intends to do.

Mr. **Blaz**. Yes, Mr. Frenzel, that is precisely the point. When we were talking about the textile industry in the earlier sessions, people were saying they wanted to protect industry and American garment workers, and I echoed it and I said, So do I, except the ones we are speaking about happen to be off shore.

Mr. **Frenzel**. Well, I am sure that Mr. Harrison will feel that way, that the administration will feel that way and that we will be able to make a bill that is going to satisfy all of the interests that are involved there. I appreciate the way you and the mayor and the domestic industry representatives have worked together to try to put together a bill. I hope that you will be able to achieve administration support.

I think you will, and I wish you all sorts of success. I do know that there are some changes since you have begun, but I hope the bill H.R. 2225, or another variation, is going to be able to make it through with this current list of bills. Do you believe we are going to be able to achieve some kind of understanding on this?

Mr. **Blaz**. I do believe that, sir. We have been working on it for several months now and indeed the phase of the document that we authorized jointly together originally has changed and it has changed in an attempt from both sides to make an accommodation so we can all live with the document. I am hopeful of that.

Mr. **Frenzel**. Mr. Segal, all of your employees are American citizens?

Mr. **Segal**. Yes, they are.

Mr. **Frenzel**. You are the largest nongovernment employer on the island of Guam?

Mr. **Segal**. That is correct, the largest.

Mr. **Frenzel**. The wages that you pay are at least comparable or above other wage patterns, nongovernment, on the island of Guam?

Mr. **Segal**. They are substantially above the nongovernments.

Mr. **Frenzel**. All you are looking for is a chance to continue the oepration there and keep those people employed?

Mr. **Segal**. We just want to stay in business. That is all we want to do.

Mr. **Frenzel**. Thank you very much, Mr. Chairman. I yield my time from my leading questions.

Mr. **Pease**. I was going to say that is the most adroit use of leading questions I have heard in quite a while. Thank you, Mr. Frenzel. Mr. Crane, did you have anything?

Mr. **Crane**. I have no questions.

Mr. **Pease**. Mr. Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman. I have one or two questions for my colleague. The first is, has the average price of these imported sweaters increased significantly since the new country-of-origin regulations were first put forth?

Mr. **Segal**. No, they have not.

Mr. **Schulze**. Have they increased at all?

Mr. **Segal**. We have not had to pay duty. If we would have to pay duty, the the average price would increase about 25 percent, which would put us out of business.

Mr. **Schulze**. You are saying the prices have not increased?

Mr. **Segal**. That is correct.

Mr. **Schulze**. It's mainly due to the lack of——

Mr. **Segal**. We have not had to pay duty. If we would have to, it would increase dramatically.

Mr. **Schulze**. Would this lead to greater transshipping through the insular possessions?

Mr. **Segal**. There is no transhipping through Guam. If the duties would be imposed, there wouldn't be any place—there wouldn't be production at all in Guam, because no one could compete. We couldn't compete with the Orient.

Mr. **Schulze**. Would this lead to transshipping?

Mr. **Segal**. I would think it would not. There are too many controls today on everything.

Mr. **Schulze**. What would the safeguards be? Why would I not be able to transship?

Mr. **Segal**. Everything that comes into the United States, Customs is very aware of where it is produced, especially if they are produced on Guam. They can just go right on the island, look at the goods, look at it being produced and see it was done in the proper manner.

Mr. **Schulze**. But does Customs do that? I hear what you are saying, but Customs doesn't do that.

Mr. **Segal**. May I turn to my colleague?

Mr. **Schulze**. Sure.

Mr **Isaacs**. The Guam Customs Service inspects all incoming shipments into Guam to ensure that the invoice correctly represents the imported products. They regularly inspect the factory to ensure that the documents which we file are accurate and then they inspect finished product prior to its being exported. In addition to that——

Mr. **Schulze**. Is there any reason why I couldn't import sweaters without labels and just sew the labels in and send them on in?

Mr. **Isaacs**. Well, one of the problems would be that the containers are not opened unless a representative of the Guam Customs Service is present at the factory.

Mr. **Schulze**. Suppose there is a customs agent there.

Mr. **Isaacs**. He would see finished sweaters at that point.

Mr. **Schulze**. They are not really finished, are they? In other words, you are putting labels in them?

Mr. **Isaacs**. Those are finished sweaters as far as the Customs Service is concerned. It must be——

Mr. **Schulze**. I guess either you didn't know I was going to ask this question or you are not prepared for it. You are not answering very well. My question is pretty clear: What safeguards are there to keep transshipments from coming through if this bill goes through?

Mr. **Isaacs**. The inspection which is conducted by the local officials at the time of importation—in other words, if a partially sewn or a fully sewn sweater is imported, it will be immediately known by the local government officials.

Mr. **Schulze**. And the Customs Service is so efficient in that area—I am going to take your word as to what they are worth. I kind of shake my head because I have been involved with the Customs Service for a long time. But you are saying that nothing is going to get through without them looking at it.

Mr. **Isaacs**. There are no complete guarantees in this world, but I can tell you this: The inspections which are conducted in Guam are much more intensive than the inspections which are conducted in the United States.

Mr. **Schulze**. You did say there is not a container opened when there is not a customs agent there?

Mr. **Isaacs**. That is correct. They are delivered to the factory under seal and that seal is not broken unless a customs official is there.

Mr. **Segal**. Congressman, sir, again I am an American, I live here. There is no way that we would permit, that it could happen. There are also many people on Guam. If people are going to resort to subterfuge, they will get caught, if not today, tomorrow. It doesn't happen.

Mr. **Schulze**. Thank you. Thank you, Mr. Chairman.

Mr. **Blaz**. Congressman, I believe the Lieutenant Governor would like to add on to that.

Mr. **Reyes**. Just to amplify the statements made concerning the customs in Guam. We, the Government of Guam, are very sensitive about the customs situation over there. We have approximately 100 customs officers within the government and we do a good job. We follow the procedures to the letter and we follow also the U.S. standards of customs inspection.

Mr. **Schulze**. Thank you.

Mr. **Pease**. Let me ask a couple of questions. Are we essentially talking about one factory, one company operating in Guam?

Mr. **Segal**. We are the only one.

Mr. **Pease**. Is there any company operating in the Northern Marianas?

Mr. **Tenorio**. Yes, sir. We use to have three sweater companies operating there but right now I think only two are actively engaged in production.

Mr. **Pease**. Two. What approximately is the employment in those two?

Mr. **Tenorio**. The local employment—when I say local I mean the people from the island and the population there—we have approximately 30 or 35 percent of the personnel level, the employment percentage. The rest of the employees are workers that were imported from foreign countries to start out the factory. The factory that we have in the Northern Marianas just started in 1984. We have not had the necessary growing-up period and training period to provide for skilled development of the Marianas' pesonnel that are in the factory.

Mr. **Pease**. What is the total number of employees?

Mr. **Tenorio**. Approximately 300 or 350.

Mr. **Pease**. That would be comparable to your factory; is that right, sir?

Mr. **Segal**. Yes, sir. Yes.

Mr. **Pease**. I get the impression that this change promulgated by the rule, customs rule, has not yet gone into effect; is that correct?

Mr. **Segal**. That is correct.

Mr. **Pease**. When is it scheduled to go into effect?

Mr. **Segal**. They are going to issue a change in practice sometime in the future. We don't know. It is like a sword over our head. We are waiting for it to fall.

Mr. **Pease**. Currently you are governed by the substantial transformation requirement; is that right?

Mr. **Segal**. That is correct, sir.

Mr. **Pease**. Customs, their new regulation specifies that what goes on in your factory is not substantial transformation in their view.

Mr. **Segal**. That is correct.

Mr. **Isaacs**. That is correct.

Mr. **Pease**. Now, the intent of the legislation that Mr. Frenzel has introduced, Mr. Blaz and Mr. Frenzel, is to maintain the status quo as far as you are concerned; is that right?

Mr. **Segal**. That is correct.

Mr. **Pease**. What percentage of the value of a sweater is represented by the operation that you conduct at your factory by the final sewing or looping or linking?

Mr. **Segal**. Well, under law it has to be more than 50 percent. It is probably closer to 60 to 70 percent in our particular plant.

Mr. **Pease**. It would be 60 to 70 percent; is that right?

Mr. **Segal**. That is right.

Mr. **Pease**. What is your production? How many sweaters do you produce annually, Mr. Segal?

Mr. **Segal**. We are currently producing between 145,000 dozen sweaters.

Mr. **Pease**. 145,000 dozen. Now, there is a quota involved here; is that right?

Mr. **Segal**. That is correct.

Mr. **Pease**. Guam can only ship a certain number of sweaters and that is an absolute quota?

Mr. **Segal**. That is correct.

Mr. **Pease**. What is that quota?

Mr. **Segal**. That is 161,000 dozen.

Mr. **Pease**. You are relatively near the quota.

Mr. **Segal**. We would be up to that, yet we have had so many ups and downs in the last 12 months we didn't know we would be in business the next month. We took the risk to start up some time in the middle of this season since we could not, we didn't know if we were going to be there or not. We do produce 15,000 dozen a month and need that production.

Mr. **Pease**. I see. And you are not seeking to change the quota; is that correct?

Mr. **Segal**. That is correct. I am just seeking to stay in business the way we are.

Mr. **Pease**. All right. So from the viewpoint of the impact of this legislation on mainland, U.S. mainland sweater producers, passage of this legislation should not change the impact that has occurred over the last few years; is that correct?

Mr. **Segal**. That is correct, sir. It will not change that.

Mr. **Pease**. Thank you very much.

We appreciate the testimony of all of you gentlemen.

Do you have anything to add, Mr. Blaz?

Mr. **Blaz**. No, sir.

Mr. **Pease**. Thank you very much.

Now I will hear from Mr. Harrison. Sorry we had to interrupt you before sir.

STATEMENT OF SETH M. BODNER, EXECUTIVE DIRECTOR, NATIONAL KNITWEAR & SPORTSWEAR ASSOCIATION, PRESENTED BY DONALD HARRISON, COUNSEL, ON BEHALF OF THE AMERICAN FIBER/TEXTILE/APPAREL COALITION

Mr. **Harrison**. I am Donald Harrison. I am appearing today on behalf of the American Fiber/Textile/Apparel Coalition. A statement has been filed—we ask that it be included in the record—by Seth Bodner, who is the executive director of the National Knitwear & Sportswear Association, which is one of the 21 member organizations of the American Fiber/Textile/Apparel Coalition.

Mr. **Pease**. That will be done.

Mr. **Harrison**. Mr. Bodner would be here today talking to you directly, but he had a problem with his back and the doctor said he should stay in bed.

I might say, by way of introduction that the American Fiber/Textile/Apparel Coalition is a group of 21 associations and unions representing the interests of domestic textile and apparel industries and workers. We appear today to express our interest in H.R. 2225.

AFTAC is particularly concerned with the effective enforcement of the import restraints on textiles and textile products that are negotiated pursuant to section 204 of the Agriculture Act of 1956. As you know, Mr. Chairman, pursuant to that statute, the Government negotiates bilateral agreements and imposes import restraints, the quotas that you referred to earlier.

Now, we understand from the statements here today and from the administration's remarks that H.R. 2225 is not intended to affect in any way those import restraints, that it deals solely with the duty impact of imports of certain textile and apparel products from Guam and from the Commonwealth of the Northern Mariana Islands. Particularly, as you mentioned earlier, it deals with a change of practice that the Customs Service proposed in August of last year, in which they indicated they were considering changing the country of origin rules for duty purposes.

By way of background, the Customs Service earlier had changed the country of origin rules for textile quota and import restraint purpose. There had been a special exception made to that in the case of sweater imports from Guam and the Northern Mariana Islands.

The effect of that exception was to permit sweater imports that would otherwise have been included in the quota limits of other countries, the Far Eastern countries from which the exporters in Guam and the Northern Mariana Islands get their sweater components. There was a special exception made for that.

In any event, AFTAC's concern is that legislation to deal with this very specific duty issue not jeopardize the effective enforcement of the Government's textile import program, and we believe that any such legislation should include a number of limitations to ensure that result.

Mr. Bodner's statement indicates in some detail the nature of those limitations, but let me just summarize briefly.

One, we believe that the legislation should be limited to imports of sweaters from Guam and the Commonwealth of the Northern Mariana Islands, which we understand is the concern. I think earlier today you heard that was the concern.

Second, we believe that the legislation should require significant assembly operations, to make it quite clear that the sewing and the linking and looping and so forth should be done completely in Guam or the Northern Mariana Islands. By that we mean not just finishing operations completing the sewing of the seams, but the complete assembly operations of the component parts.

Third, and most importantly, we believe that the duty free imports that would be permitted under this legislation should be limited to the levels that have already been agreed to in the quotas that you referred to earlier, that is the approximately 160,000 dozen sweaters from Guam and the approximately 70,000 dozen sweaters from the Commonwealth of the Northern Mariana Islands.

The reason for this is really quite clear. This effort to protect the interests of those that had set up operations in these locations should not be permitted to be used as a vehicle to expand the duty free treatment of what are essentially products of other countries.

Fourth, the local labor requirements should be clarified. H.R. 2225 does not contain express local labor requirements, but we understand that the Interior Department has proposed requiring specific local labor requirements for producers to be eligible for this special duty free treatment.

The nature of the clarifications I won't go into here, but are specified or spelled out in Mr. Bodner's statement.

Finally, let me pick up on a point that Mr. Schulze raised earlier. We believe the operation should be subject to strict on-site inspection and other monitoring to ensure that the requirements of the legislation are being met and that the legislation does not permit trans-shipment or other evasion of the textile import program.

That concludes my remarks, Mr. Chairman I would be glad to respond to any questions, of course.

[The statement of Mr. Bodner follows:]

Summary of Statement of
American Fiber/Textile/Apparel Coalition (AFTAC)
By
Seth M. Bodner, Executive Director
National Knitwear & Sportswear Association
on H.R. 2225
Presented to the Subcommittee on Trade,
Committee on Ways and Means
United States House of Representatives,
February 6, 1986

1. The statement is on behalf of the American Fiber/Textile/Apparel Coalition, a 21-member organization representing the majority of the domestic textile and apparel industries in the United States.

2. AFTAC is particularly concerned with effective enforcement of textile and apparel import restraints negotiated and/or imposed pursuant to Section 204 of the Agricultural Act of 1956; we understand that H.R. 2225 is not intended to and would not effect such restraints; instead we understand that H.R. 2225 would only effect the duty status of imports from Guam and the Northern Mariana Islands, the subject of General Headnote 3(a) of the Tariff Schedules of the United States.

3. Specifically, we understand that H.R. 2225 arises out of concern with changes in the "country of origin" rules for duty purposes, which the Customs Service proposed in August 1985.

4. AFTAC is concerned that any legislation to deal with this specific duty issue does not jeopardize effective enforcement of the textile import program. Specifically, any such legislation should include the following limitations:

(a) The legislation should be limited to imports of sweaters from Guam and the Commonwealth of the Northern Mariana Islands (CNMI), which we understand is the concern of its sponsors;

(b) The legislation should require the type of significant assembly provided in the Interior Department's redraft, with the qualification that the required sewing, looping, linking, etc. should be done completely in Guam or the CNMI;

(c) Most importantly, duty-free imports under the legislation should be limited to the levels that have already been specifically provided by the Committee for the Implementation of Textile Agreements (CITA) for this trade;

(d) The "local labor" requirement in the Interior Department's redraft should be clarified; and

(e) The operations involved should be subject to on-site inspection and other monitoring by the United States Government to ensure that the requirements are being strictly satisfied; benefits under the legislation should terminate automatically if the requirements are not being satisfied.

I am Seth Bodner, Executive Director of the National Knitwear & Sportswear Association (NKSA), a national association representing more than 400 knitwear and sportswear manufacturing and design firms plus more than two hundred supplier company members including producers of yarns, fibers, machinery and other materials and services related to production of knitwear and sportswear. NKSA's membership is diversified, and includes producers of sweaters, knit shirts and blouses, headwear, coordinated knit and woven sportswear, knit dresses, swimsuits, and various accessory products. Our members are located throughout the United States. My statement is on behalf of the 21 member organizations of the American Fiber, Textile, Apparel Coalition (AFTAC) which represents the majority of the domestic textile and apparel industry. (See membership list attached.)

I am here today to present testimony on H.R. 2225, relating to the Customs treatment of certain wearing apparel produced in the insular possessions of the United States. AFTAC is opposed to H.R. 2225 as currently written and as modified by recommendations put forth by the Department of the Interior. H.R. 2225, as amended by language reccmmended by the Department of the Interior, proposes special liberalized treatment for imports of apparel articles, including knitted sweaters from Guam and the Northern Mariana Islands. As a compromise to the original bill introduced by Messrs.

Blaz and Frenzel, the Executive Branch appears to propose a special tariff exemption on sweaters subject to the quota waiver (160,000 dozen sweaters annually from Guam and, 70,000 dozen sweaters annually from the Northern Mariana Islands). The tariff exemption would be for a period of ten years.

On the face of it, this approach is certainly an improvement over the original bill; however, in light of the overall textile and apparel import situation, and in particular, that of the domestic sweater producers, the problems remaining in the Interior Department's suggested rewrite are formidable.

The statistics on textile and apparel imports are by now very familiar to Subcommittee members. In 1984, imports increased by 32 percent after a 25 percent increase in 1983. Imports continued to grow in 1985, when the textile/apparel trade deficit exceeded $18 billion. In the knitwear apparel sector, employment in knit outerwear mills has been falling steadily since 1980 while knit apparel imports have skyrocketed. Sweater imports, including those covered by the Multi-Fiber Arrangement (MFA) and those outside the MFA, now have about 68 percent of the domestic sweater market, with imports of MFA-covered sweaters at 16 million dozen and imports of non-MFA covered sweaters at 8 million dozen. These import numbers compare to an estimated domestic production of 11 million dozen sweaters of all fibers in 1985.

I cite these statistics so the Subcommittee will understand why we are concerned and why we are asking the members of the Subcommittee not to take any action that will further exacerbate our problems by encouraging additional sweater imports.

It should be understood that members of our Association have lost orders resulting in lost employment opportunities for domestic workers as a direct result of the pricing advantages associated with Guam's access to low-cost Korean and Chinese knit components. The proposed legislation perpetuates a preferred status for the Guam-based firm, and would extend that status to the Marianas, a status which has a direct adverse impact on U.S.-based manufacturing companies. With this in mind, I would like to make a few comments about the compromise recommended by the Interior Department.

First, there is no question that products wholly manufactured in Guam and the Marianas can enter the United States free of duty. There is even room for duty-free imports for products partially manufactured in the possessions based on U.S. Customs rules.

Second, the situation in the Northern Marianas is quite different from that in Guam. In the former, it is our understanding that the operations are newly created, using imported labor. We further understand that a Customs Service inspection uncovered substantial fraud and transshipment concerning the movement of Chinese and other Far East quota-country sweaters into the United States in circumvention of the existing import control program.

We also believe the situation concerning the operations in Guam differ substantially from those in the Marianas in their historical foundation. The Guam operation has been established for some time, and has taken full advantage of Customs rulings and practices existing at the time the operation was set up. The Marianas production facilities appear to have emerged only in the past year or two, and to have been largely the product of a desire to avoid U.S. textile agreements with China and other major Far East producers. We see no sound reason to grandfather those operations simply because they are located in the Marianas. It should be clear that under the terms proposed by Interior, these operations -- both Guam and Marianas -- would enjoy privileges greater than those available to U.S. firms, i.e., the right to import Chinese knit components for assembly free of quota and duty. Moreover, while the Guam producer pays the U.S. minimum wage, it is our understanding that this is not the case in the Marianas.

Third, the bill is totally open ended. New companies could set up plants based on these assembly operations, with no requirement to set up the kind of full scale manufacturing needed and desired in the possessions. We see absolutely no policy reasons to encourage the formation of businesses premised on quota avoidance by reliance upon quota-country knitting being used as the basis for garments assembled in Guam or the Marianas. Furthermore, under one possible interpretation of the proposed bill, all Hong Kong sweater parts could be run through Guam and enter the United States free of duty, even though they might still be charged to the Hong Kong quota. They would remain Hong Kong goods for quota purposes under the rules of origin, but would achieve massive market advantages by virtue of the open ended duty suspension.

Fourth, we do not understand the rationale for a ten-year duty suspension. Given the previously noted problems in the Northern Mariana Islands, a much briefer suspension should be contemplated -- perhaps three years -- and it should lapse automatically at the end of each calendar year unless annual inspection and full audit by the Customs Service has determined that all trade conducted by and through those factories is in full compliance with U.S. regulations relating to the textile and apparel import control program. The suspension should lapse in the final year unless the Congress again considers the matter and passes further legislation to suspend the duties.

Fifth, we do not understand Interior's use of the phrase "local labor requirement." What is "local labor" in this context? Who decides it? How is it certified? What check exists to prevent abuse? How will the Congress be informed of enforcement efforts on this point? Furthermore, assuming those issues can be addressed satisfactorily in the law, how does one interpret the percentage figures on employment? Is this a measure of numbers of people? Of hours worked by "local labor" as a percent of total hours worked? A measure of salaries paid? Assuming it is the first of this series, what time period is used to establish the measures? How does the enforcement agency determine that the payroll has not been loaded for a brief period to meet the test of "during any time" as recommended by the Interior Department while maintaining freedom to import foreign labor during the high out-put periods of the facility?

Sixth, the provisions authorizing the Secretary of Interior to enforce the legislation are defective because they are too discretionary. The Secretary defines "local labor"; he is given the choice of conducting on site inspections; he is authorized to suspend certifications and to revoke them. He is not expressly directed to do any of these things.

Seventh, the concern behind the legislation has to do, so far as we are aware, with sweaters. The opening description in the proposed legislation refers to "Any article of wearing apparel..." We see no reason to apply this legislation to all such "articles." It should be limited to sweaters.

Eighth, the language does not indicate the extent of the sewing, looping, etc., required to meet its test. Thus, it fails to make clear that the articles must be "completely" sewn, etc. In other situations, importers have urged that very minor sewing provides enough basis to claim origin, e.g., sewing the last two inches of a cuff when the sleeve seam had already been sewn. We believe insertion of the word "completely" after "... (by...)" should go far toward assuring that the duty free entry is reserved for those truly intended to receive it.

Finally, and most importantly, we believe that it is a mistake not to put an absolute limit on the quantity of goods authorized to be eligible for this duty-free entry. The quantity specified should be that provided for in the agreements established by the Interior Department in its recent exchanges of letters with the Guamanian and Marianan authorities. Moreover, there is an apparent inconsistency on this point between the text of the bill recommended by the Interior Department and the narrative description in the Interior Department's letter to Chairman Rostenkowski dated October 23, 1985. The letter states that the temporary duty suspension will be "on the products subject to the quota waiver"; the language of the bill, however, has no such limitation. The bill language needs to be clarified on this point.

The issue here is not a matter of preventing Guam and the Marianas from developing vital manufacturing operations. Nothing we have suggested opposes such development. Our concern, again, is with the unjustified development of a loophole in the system which would permit the insular possessions to be used as a partial processing point and a source of relabeling to evade quotas and tariffs. Moreover, it is simply not sound policy for industries in the insular possessions to be premised on the evasion of established government agreements.

On the basis of the foregoing comments, we cannot support this legislation. We are willing to consider the bill again if the problems we see with it are rectified. I appreciate the opportunity to appear here before you today.

AMERICAN FIBER, TEXTILE, APPAREL COALITION

Amalgamated Clothing & Textile Workers' Union, AFL-CIO
American Apparel Manufacturers Association
American Textile Manufacturers Institute
American Yarn Spinners Association
Carpet and Rug Institute
Clothing Manufacturers Association of U.S.A.
Industrial Fabrics Association International
International Ladies' Garment Workers' Union, AFL-CIO
Knitted Textile Association
Luggage and Leather Goods Manufacturers of America
Man-Made Fiber Producers Association
National Association of Hosiery Manufacturers
National Association of Uniform Manufacturers
National Cotton Council
National Knitwear & Sportswear Association
National Knitwear Manufacturers Association
National Wool Growers Association
Neckwear Association of America
Northern Textile Association
Textile Distributors Association
Work Glove Manufacturers Association

Mr. **Pease**. Thank you very much.

Mr. Crane?

Mr. **Crane**. No questions.

Mr. **Pease**. Mr. Schulze.

Mr. **Schulze**. No questions.

Mr. **Pease**. Mr. Harrison, I gather you are here expressing interest, not necessarily opposition; is that correct?

Mr. **Harrison**. Well, the domestic industry has not opposed the special quotas that were announced by the Comittee for the Implementation of Textile Agreements last year following the country of origin regulation, and our interest is in making sure that the legislation as enacted does not provide loopholes that would undermine the effective enforcement of the program.

Mr. **Pease**. I was glad to hear you bring up the point about requiring significant assembling. As I look at the bill, it states that any article which is assembled in an insular possession is ipso facto considered to be substantial transformation which means in my view that someone could get around that by doing 95 percent of the work somewhere else and bring it in, just putting on the last little bit of assembling.

I think we all want to guard against that.

Mr. **Harrison**. I might say, Mr. Chairman, that it is for that reason that the domestic industry would certainly oppose H.R. 2225 as it was introduced.

What I meant to convey was that if some of our concerns are addressed, the legislation may be designed or redrafted in such a way as to address those concerns. But you touch on what I think are one of the two potentially, significant problems with the legislation as drafted, which is there is no qualification of the term "assembly." As you know, that term can be subject to much interpretation and misinterpretation.

A second principal problem is, as I mentioned earlier, there is no limitation on the quantities, so that as drafted companies producing sweater components in Far Eastern countries could ship them to the Northern Marianas or Guam and have whatever would qualify as assembled satisfy the country of origin rules in this legislation and come in duty free, even if the sweaters were treated as part of the quota of the Far Eastern country.

Of course, that would be completely inconsistent with the tariff schedules and effective enforcement of the import program.

Mr. **Pease**. What do you mean when you are talking about local labor requirements?

I am not quite sure what that means.

Mr. **Harrison**. Well, the purpose of the initial response by the Committee for the Implementation of Textile Agreements providing the quota exception to the normal country of origin rules was to recognize the interests of the local labor interests in Guam and the Commonwealth of the Northern Mariana Islands. Now we understand from the testimony earlier today that in the case of the Guam operation they use 100 percent local labor, but in the case of the Commonwealth of the Northern Mariana Islands, apparently that is not the case. This is a point that I believe the representative from the administration made earlier today, that is that there ought to be some express statement in the legislation about the requirements for local labor.

Mr. **Pease**. When you talk about local labor, you are talking about American citizens who are indigenous to the island.

Mr. **Harrison**. That is correct.

Mr. **Pease**. Do you have a comment on behalf of your association regarding the administration's position that it would not want to amend the headnote, but that it would be willing to support a suspension of duty for 10 years?

Mr. **Harrison**. Well, I think in terms of the format of any change, a duty suspension seems preferable to amending the headnote 3(a) definition. We are particularly concerned that the country of origin issues are presented in a number of different contexts, and here we are dealing with an exception to the normal rules.

The Customs Service, pursuant to a directive from the President, developed new country of origin rules dealing with textile imports generally. What we have here is an exception that was made by the administration because of the interests of Guam and the Commonwealth of the Northern Mariana Islands, and we certainly would not want to see that exception jeopardize the principal result in the country of origin rules.

Mr. **Pease**. OK. I think there are no more questions. We appreciate your testimony, Mr. Harrison.

Mr. **Harrison**. Thank you.

Mr. **Pease**. The next bill we will deal with is H.R. 2349. Mr. Pearlman and Mr. Kraft, if you will come to the table, please. At this point in the record there will appear a statement by Chairman Rostenkowski on the subject of H.R. 2349, which he has introduced.

It so happens that the primary proponent of the legislation and the primary opponent of the legislation are both from Chicago and each employs a large number of the chairman's constituents. The chairman, who is a member of this subcommittee, regrets not being able to be here today and has asked me to welcome our next two witnesses in his name.

As I say, a full statement by Chairman Rostenkowski will appear in the record at this point.

[The statement of Mr. Rostenkowski follows:]

STATEMENT OF CHAIRMAN DAN ROSTENKOWSKI ON H.R. 2349

Thank you, Mr. Chairman, for this opportunity to make a few observations about my bill, H.R. 2349, the next on the Subcommittee's hearing agenda. I will also include a few words about the two witnesses who will be testifying.

I introduced H.R. 2349 for the purposes of focusing the attention of the my colleagues on what strikes me as a clear circumvention of Congressional intent, and of doing something to set the matter straight.

As is described in documents before the Trade Subcommittee, there is, today, a growing reliance on what could be called the "Mexican three-step" system of bringing foreign-made TV picture (and other cathode ray) tubes into the United States.

Simply put, the first step is to deliver the tubes to Mexico from their country of origin, usually in the Far East. In Mexico, and still in their original packing, the tubes are paired with matching chassis and control panels, in equal number, on the same truck -- step two. The paired sets of boxes are then shipped to assembly points within the States -- step three.

Once in the States, the tubes are finally removed from their original packing and assembled with the matched components which entered the U.S. on the same truck. Also added at this point are the remainder of the parts required to make a complete television, including the cabinet.

Two important points to note in this system are (1) that no operations are performed on the tubes while they are in Mexico other than the pairing with the matched partial set of components, and (2) that what comes in on the truck from Mexico is far from being everything needed to assemble a complete television.

Why would the importing television industry go to this kind of trouble to pass these tubes through Mexico? What purpose is served by pairing them with some, but far from all, of the components needed to make a complete TV, before crossing the border?

It happens that a number of rulings by the Customs Service say, in effect, that the "Mexican three-step" will result in lowering the tariff due on imported color television picture tubes from 15% to 5% ad valorem. The rulings turn on a determination, by Customs, that the imported merchandise, although consisting of considerably less than all the parts needed to make a TV, is an "unfinished television receiver" and thus dutiable at the lower rate.

There appears to be no disagreement that the sole purpose of going to all this trouble is to take advantage of that ruling.

No one was more surprised than I to learn that this scheme has been sanctioned by Customs. I have trouble understanding the reasoning behind the ruling but, certainly, no one can accuse those using this scheme of doing anything untoward or smacking of bad faith. In fact, I have reason to believe that those who have chosen to take advantage of the ruling have bent over backwards to secure assurances of favorable treatment from Customs before putting those operations in place.

It should be remembered, of course, that Congress has carefully reserved to itself the power to set this country's tariffs. Reliance on a ruling of such questionable adherence to Congressional intent brings with it a certain risk that we will take action necessary to clarify the law.

As we look for answers on how this state of affairs could have come about, we might find that we are, in fact, partially to blame. Perhaps we could have made our intent more clear. Perhaps the Customs Service, finding insufficient guidance in the legislative history of television tariff classifications, had to fall back on its own line of precedents, or its need for administrative convenience, in reaching its ruling. That would certainly make understanding the ruling a little easier.

In any event, given the Customs ruling, the growing reliance on it, and the concerns of the domestic tube producers on what they see to be a dangerous growth in import penetration due to that reliance, I felt it would be advisable to return the matter to the hands of the Congress. Through this hearing process and our subsequent debate of the issue, I hope that we will be able to get a firm grasp on what is happening, and decide to make another attempt at instructing our tariff collectors as to what we really want done about foreign-made TV tubes.

I note with interest that the United States Trade Representative agrees with the purpose of H.R. 2349, which he properly sees as one of clarification and restoration of the original intent of Congress. I welcome Ambassador Yeutter's offer to help us meet those objectives.

Mr. Chairman, there is an ironic twist in this piece of legislation, for me, and that brings me to the witnesses before you. It so happens that the primary spokesman in favor of the bill, and the primary spokesman in opposition to the bill are both respected businessmen from my part of the country. In fact, they both head major television operations in Franklin Park, a suburb of Chicago which I am proud to say falls within the Eighth Congressional District, which I am privileged to represent.

Jerry Pearlman is Chairman and President of Zenith Electronics Corporation, which makes and markets its own television line, as well as supplies other manufacturers with television tubes. Zenith's major TV facility is right on the edge of my district.

Dick Kraft is President of Matsushita Industrial Company, which assembles and markets Quasar and Panasonic televisions, using both imported tubes and domestic tubes, including some made by Zenith. MIC is located right in my district.

Both Mr. Pearlman and Mr. Kraft run marvelous research and industrial complexes of the highest technological state. Both Zenith and Matsushita are at the top of the industry in such things as product development and employee relations. (I have had the pleasure of a most impressive tour of the Matsushita facility, which is in the old Motorola plant, now greatly expanded and modernized. I hope soon to be able to accept a longstanding invitation to do the same at Zenith.)

Both Zenith and Matsushita employ hundreds of my constituents, and are supplied by many of the small businesses in my district, and I do not have to explain the significance of that to my colleagues on the Subcommittee.

The big difference between these two anchor businesses in my district, at least for purposes of our deliberations on H.R. 2349, is the fact that Matsushita relies heavily on the Customs ruling in question, while Zenith not only does not, but claims that the availability of the loophole is crippling its domestic marketing.

As might be expected, both Mr. Pearlman and Mr. Kraft have supplied me with a lot of information on the extent and effect of the Mexican connection, and on what they see as the likely impact of the clarification embodied in H.R. 2349. As might also be expected, some of that information is in conflict, as are the conclusions drawn from it.

One aspect of these differing opinions is particularly troubling to me. From the very introduction of H.R. 2349, Matsushita has claimed that passage of the bill would require it to give serious consideration to the idea of moving some or all of its Franklin Park operations out of the country.

I want to make it clear that I value highly the longstanding presence of Matsushita in my district, and that I would be extremely disappointed if the jobs there were relocated. If H.R. 2349 is enacted, I hope that the officers of MIC would agree with me that Franklin Park is still a great place to do business, and a place represented by a Congressman dedicated to working together with them on other matters.

In closing, Mr. Chairman, let me say that I welcome the interest which the Subcommittee has shown in my bill, because I certainly can use the help in sorting out its advantages and disadvantages. I regret that illness will keep me away from the hearing today, but I urge you to welcome Messrs. Kraft and Pearlman in my name. Take full advantage of the experience and expertise which they bring before you. I look forward to discussing the matter with the Members of the Subcommittee subsequent to the hearing, and to continuing my work with these worthy gentlemen.

Mr. PEASE. Now, we would like to hear the testimony first of Mr. Jerry Pearlman, chairman and president of Zenith Electronics Corp. Mr. Pearlman.

STATEMENT OF JERRY K. PEARLMAN, CHAIRMAN AND PRESIDENT, ZENITH ELECTRONICS CORP.

Mr. PEARLMAN. Thank you. I want to thank the chairman and members of the subcommittee for the opportunity to be here today and to represent the entire domestic picture tube and glass industry. First, a word about Zenith.

They have been a pioneer in the television industry since the industry started at the end of World War II. Zenith is one of the first manufacturers to make its own color picture tubes. They invented the black matrix picture tube which is now the industry standard and developed many other picture tube technical innovations but we need your help if we are going to stay in the picture tube business.

We submitted a formal statement of support to this subcommittee in June 1985. Today I do not intend to repeat that statement but I will spend a few minutes describing the urgent needs for this legislation. I know that I speak for the entire domestic picture tube and glass industry in urging you to support H.R. 2349 and report it favorably out of this committee.

The bill would close the loophole in the U.S. tariff schedules. A loophole is not simply our choice of words, it is also the word used in the statement from the special—from the U.S. Trade Representative Office commenting on the bill. That loophole permits foreign manufacturers to circumvent the intent of Congress by paying only a fraction of the required import duties to the Federal Government.

This loophole arose from a strained administrative interpretation of a tariff classification added in 1976 to measure performance under an orderly marketing agreement. Using this loophole, companies can import color television picture tubes at a 5-percent duty—a full 10 percent below the 15-percent rate intended by Congress.

I want to emphasize that H.R. 2349 is not a tariff increase. It will simply require picture tube importers to pay Customs duties as specified by Congress.

Let me explain briefly why this legislation is so important. The picture tube is by far the most costly component of a color television receiver. It accounts for up to 45 percent of the material value of a television set.

Color television picture tubes are being overproduced in the world market. Free world production capacity of color picture tubes is estimated at about 70 million units annually while demand is substantially less. Despite the overcapacity, new plants are being built in Korea and China that in a few years will be capable of producing an additional 20 million picture tubes per year.

History teaches that this excess production always ends up being dumped in the United States, severely affecting pricing in the domestic market. In 1980, the average price of a 19-inch color picture tube was about $80. It is about $65 today.

I glanced through Mr. Kraft's testimony and he is going to refer to 1979 pricing, and I thought I ought to do that also.

The 1980 pricing was higher than 1979. The 1979 pricing was about $70 for a picture tube. It got up into the mid $80 price range in 1982, but Korea, Taiwan, Singapore exporting into this market and the use of this loophole starting in 1983 have driven the price down from roughly $85 in 1982 to the $65 that I just mentioned in 1985 which is almost 10 percent below the 1979 price.

Material costs have increased over the same period. So all of this price reduction has come out of our margins and the profitability of the industry. Even in this depressed pricing environment, imports have been increasing at an alarming rate.

In 1982, about 27 percent of television sets sold in the United States had foreign picture tubes. In 1985—just 3 years later—that 27 percent had grown to 48 percent. It follows that the U.S. television producers who have struggled to break even in the 1970's and early 1980's all lost money in 1985—a year of record unit sales volume in the United States.

These conditions have persisted for many years because television has long been a targeted industry by the Far East. This caused Congress years ago to conclude that a 15-percent duty rate on picture tubes was essential for the survival of both the domestic television and picture tube industry.

However, this congressional purpose is now being severely circumvented by at least one prominent Japanese television manufacturer through manipulation of our Customs classification laws. To make sure you know how the duty evasion scheme works, I will give you an example of a Japanese company.

Picture tubes arrived from Japan into California. The tubes are then taken in bond to meet up with Mexican electronics produced at a components facility. No United States or Mexican duty is paid.

The manufacturer then officially imports the tubes into the United States with a like amount of television electronics, but not all of the electronics necessary to make a complete television set. There are no speakers, cabinets, yokes, and many other pieces.

They come in separate boxes and then they are shipped to an assembly plant in Illinois. If the manufacturer had straightforwardly sent the picture tubes directly from California to Illinois, it would have paid the 15-percent duty intended by Congress. But, because of a Customs ruling, the manufacturer imports the tubes through Mexico at the 5-percent duty rate for unassembled television receivers.

H.R. 2349 is designed to close this loophole in our tariff classification law. And, if it is not closed, many other television manufacturers will no doubt use the same device to pay 10 percent less duty and many will switch from domestic-built tubes to imports.

Between 1984 and 1985 actual production of U.S. manufactured picture tubes fell by 1.8 million tubes. They should have gone up because the industry went up so we feel the total number is about 2.3 million units.

That is about the output of Zenith's tube plant, and roughly the capacity of the plant that Philips closed in Seneca Falls in 1985. The impact was spread among the whole industry, Zenith, RCA, Philips, and GE, and the two glass factories, Owens & Corning. We think the impact on pretax profits to this industry was about $50 million in 1985.

Gentlemen, the picture tube and television industry need a fair opportunity to compete and make investments or we will see the demise of domestic industry. The loophole that H.R. 2349 will close threatens unfairly the continued existence of an industry born and nurtured in the United States at great cost. The loophole threatens the jobs of thousands of U.S. workers and deprives the U.S. Government of many tens of millions of dollars in revenue.

H.R. 2349, in restoring the 15-percent duty rate Congress intended to apply to the importation of color picture tubes, represents an important step in the right direction. I urge you to report the bill favorably out of your committee.

Thank you.

[The prepared statement follows:]

STATEMENT OF JERRY K. PEARLMAN, CHAIRMAN AND PRESIDENT, CHIEF EXECUTIVE OFFICER, ZENITH ELECTRONICS CORP.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

H.R. 2349 would close a loophole in the tariff schedules created by a highly controversial administrative ruling which permits the importation of color television picture tubes at a 5 percent duty rate rather than the 15 percent duty rate intended by Congress.

Zenith Electronics Corporation strongly supports H.R. 2349 and urges that the bill be reported favorably out of this Committee.

Members of the subcommittee, my name is Jerry Pearlman. I am chairman, president and chief executive officer of Zenith Electronics Corporation. I want to thank the chairman and members of this subcommittee for the opportunity to be here today.

A word about Zenith. Zenith has been a pioneer in the television industry since the industry started at the end of World War II. Zenith was one of the first U.S. manufacturers to make its own color TV picture tubes. Zenith invented the black matrix picture tube which is now the industry standard, and developed many other picture tube technical innovations. But we need your help if we are to stay in the business.

We submitted a formal statement of support to this Subcommittee in June 1985. Today, I do not intend to repeat that statement, but will spend a few minutes explaining the urgent need for this legislation. I know that Mr. Donahue from RCA and I speak for the entire domestic industry in urging you to report H.R. 2349 favorably out of this committee.

This bill would close a loophole in the U.S. Tariff Schedules that permits foreign manufacturers to circumvent the intent of Congress by paying only a fraction of the required import duties to the Federal Government. This loophole arose from a strained administrative interpretation of a tariff classification added in 1976 to measure performance under an orderly marketing agreement. Using this loophole, companies can import color television picture tubes at a 5-percent duty—a full 10 percent below the 15-percent rate intended by Congress.

I want to emphasize that H.R. 2349 is not a tariff increase. It will simply require picture tube importers by pay Customs duties as specified by Congress.

Let me explain briefly why this legislation is so important. The picture tube is by far the most costly component of a color television receiver. It accounts for up to 45 percent of the material value of a television set.

Color television picture tubes are being overproduced in the world market. Free world production capacity of color picture tubes is estimated at about 70 million units, while demand is substantially less. Despite the overcapacity, new plants are being built in Korea and China that in a few years will be capable of producing an additional 20 million picture tubes per year.

History teaches that this excess production always ends up being dumped in the United States, severely affecting pricing in the domestic market. In 1980, the average price of a 19-inch color picture tube was about $80. It's about $65 today. Material costs have increased over the same period.

Imports at these prices have been increasing at an alarming rate. In 1982, about 27 percent of television sets sold in the United States had foreign picture tubes. In 1985—just 3 years later—that 27 percent had grown to 48 percent. It follows that the U.S. television producers who have struggled to break even in the 1970's and early 1980's all lost money in 1985—a year of record unit sales volume in the United States.

These conditions have persisted for many years because television has long been a targeted industry. This caused Congress years ago to conclude that a 15 percent duty rate on picture tubes was essential for the survival of both the domestic television and picture tube industry.

However, this Congressional purpose is now being actively circumvented by at least one prominent Japanese television manufacturer through manipulation of our Customs classification laws.

Let me tell you how this duty evasion scheme works. Picture tubes are shipped from its plant in Japan to California. The tubes are then trucked in bond to its Mexico components facility, so no United States or Mexican duty is paid. The manufacturer then officially imports the tubes with a like number of television electronics, in separate boxes, and ships them to its assembly plant in Illinois.

If this manufacturer had straightforwardly sent the picture tubes directly from California to Illinois, it would have paid the 15-percent duty intended by Congress. But, because of a Customs ruling, the manufacturer imports the tubes through Mexico at the 5 percent duty rate for unassembled television receivers.

H.R. 2349 is designed to close this loophole in our tariff classification law. And, if it is not closed, many other television manufacturers will no doubt use the same device to pay 10 percent less Customs duty on imports and many will switch from domestic-built tubes to imports.

Between 1984 and 1985 actual production of U.S. manufactured picture tubes fell by 1.8 million units. To this number should be added another 500,000 tubes for market growth that U.S. tube manufacturers would have recorded had they held market share while the color television set industry expanded to new record levels in 1985.

These 2.3 million lost units represent the output of one fair-sized color picture tube plant in the U.S. industry. The loss is roughly equivalent to Zenith's tube production in 1985. It was roughly the capacity of the North American Philips Seneca Falls, New York, tube plant that was closed last year. The impact was spread among four companies: Zenith, RCA, Philips, and GE. Had it all been at Zenith, the impact would have been all 2,200 jobs in our picture tube business. The impact in pretax profit to U.S. tube makers was about $50 million.

Gentlemen, the U.S. picture tube and television industry needs a fair opportunity to compete and make investments or the demise of the domestic industry is imminent. The loophole that H.R. 2349 will close threatens unfairly the continued existence of an industry born and nurtured in the United States at great cost. The loophole threatens the jobs of thousands of U.S. workers and deprives the U.S. Government of many tens of millions of dollars in revenue.

H.R. 2349, in restoring the 15 percent duty rate Congress intended to apply to the importation of color picture tubes, represents an important step in the right direction. I urge you to report the bill favorably out of your Committee.

Thank you.

Mr. **Pease**. Thank you very much, Mr. Pearlman.

Mr. Kraft.

STATEMENT OF RICHARD KRAFT, PRESIDENT, MATSUSHITA INDUSTRIAL CO.

Mr. **Kraft**. Thank you, Mr. Chairman, and thank you very much for this opportunity to express our views.

Mr. Chairman, and members of the subcommittee, I am Richard Kraft, president of Matsushita Industrial Co. of Franklin Park, IL, which I will call MIC. MIC is a manufacturing division of MECA, or the Matsushita Electric Corporation of America, headquartered in Secaucus, NJ, and MECA is the principal U.S. subsidiary of the Matsushita Electric Industrial Co. of Osaka, Japan. Again, I very much appreciate this opportunity to express our views on H.R. 2349.

We are aware of the concerns regarding the current trade balance with Japan. However, let me emphasize to you that this particular bill will not help to improve the trade picture or stimulate the purchase of U.S-made color picture tubes. Rather, the bill would reverse a longstanding valid Customs ruling and policy to the detriment of the workers, the investment and the community at our facility in Franklin Park, IL. While this is clearly not what the bill was intended to accomplish, it will nevertheless have that result.

MIC's facility in Franklin Park produces about 55 percent of the color television marketed for U.S. consumption under the Panasonic brand label and over 80 percent of those sold under the Quasar brand. In Franklin Park, we operate the design, engineering, assembly and distribution facility. We employ about 1,400 skilled, dedicated employees who average some 12 years of service at our factory.

We buy approximately $70 million worth of parts and components from U.S. vendors in addition to about $40 million in color picture tubes purchased from U.S. suppliers. We use parts produced in our sister company plant in Tennessee. And for some of our sets we import matched circuit boards, chassis, control panels and picture tubes from our Tijuana, Mexico factory. These matched imports are, I have come to learn through these proceedings, what the Custom's law classifies as color television assemblies having picture tubes. H.R. 2349 would increase the duty on the picture tube portion of these assemblies from 5 percent to 15 percent.

My goal as a businessman has always been to operate our factory in the most efficient and profitable way and to expand its capabilities in this highly competitive marketplace.

From the beginning of Matsushita's ownership of the Franklin Park facility in 1974 and until 1982, we purchased nearly all of our picture tubes from the four U.S. suppliers, Zenith, RCA, G.E. and Phillips. These four picture tube manufacturers are, I am sure you know, also our top competitors in the consumer television receiver marketplace. Our very existence was threatened in 1981 and 1982, when we faced another of a series of picture tube price increases from those suppliers, which brought the total cost for domestic picture tubes to 30 percent over 1979 levels.

At that point we could have simply closed the doors in Franklin Park and moved our production to Mexico, where we already had a facility. But we didn't do that. Instead, in accordance with our overall corporate goal of rapidly expanding domestic production, we continued to make substantial investments and other changes in Franklin Park, and instituted an ongoing effort to hold the line on all of our costs, especially picture tube costs.

A vital part of that effort was the Customs ruling we obtained in 1981 confirming the duty would be 5 percent on imports of chassis, control panels and picture tubes from our Mexican facility. I want to emphasize that we did not import assemblies until we had received this ruling, and that we relied on this ruling in going forward with our modernization program. I am proud of the achievements we have made. Our plant is now efficient and profitable, and we have increased our work force from 1,100 in 1982 to nearly 1,400 today.

All of this, however, is now threatened by H.R. 2349. In today's competitive environment, we could not afford to maintain our Franklin Park facility as we run it today, if we had to pay the increased duty that the passage of this bill would impose. This increase is a major cost increase for us. For example, one of our investments, the multi-million-dollar investment we made in production lines was made for the purpose of reducing our costs by approximately 1 percent. This bill would in one stroke increase our costs for the sets involved by 3 percent.

The bill itself suggests what we could do if it passed. Since completed television sets are dutied at 5 percent, MIC would be forced to examine very seriously the option of expanding our Mexican facility to build completed sets, not merely assemblies. If we were to move this way, the losers would be those of us who work and who put so much effort into our activity in Franklin Park. In addition, Mexican assembled sets would contain a higher percentage of Japanese made picture tubes than we now have in sets made in Franklin Park. Further, other local domestic suppliers of parts and components other than picture tubes, which we now buy for use in Franklin Park, could lose in a big way, perhaps amounting to as much as $70 million in sales.

Let me spend a minute more to explain what our current picture tube purchasing policy is and why it is the way it is. First, we now buy, and we plan to continue to buy, about 50 percent of our picture tube needs from U.S. producers. This is a company policy associated with our desire to be a truly American producer and it is a practical business policy based on the concerns about the continuity of supply and the fluctuations of costs of foreign made picture tubes.

Second, we will continue to hold our purchases of U.S. made picture tubes to a certain level because of our concern that the prices could rise sharply again as they did in 1979 to 1981, and because we have decided that it is not healthy for us to be totally dependent on our major television competitors for the most vital component of our sets. And, third, we enjoy the high quality of our foreign made picture tubes. We have found that the production line defect rates of U.S. made picture tubes, unfortunately, are 2 to 8 times higher than that of our Japanese supplied tubes.

In sum, I would only like to reemphasize that this bill, which at first appears to be either an arcane change in customs law or a pro-American trade bill, is in fact neither of these. I am in my 35th year in this industry, and I firmly believe that this bill would very substantially disrupt the functioning of my American television producing facility to the jeopardy of our workers, our suppliers and our community.

And I therefore urge you not to approve H.R. 2349. Thank you very much for listening. I would be glad to answer any questions that you might have.

[The prepared statement follows:]

TESTIMONY OF
RICHARD KRAFT
PRESIDENT, MATSUSHITA INDUSTRIAL COMPANY

Mr. Chairman and Members of the Subcommittee, I am Richard Kraft, President of Matsushita Industrial Company of Franklin Park, Illinois. MIC is a manufacturing division of MECA, or the Matsushita Electric Corporation of America of Secaucus, New Jersey. MECA is the principal U.S. subsidiary of Matsushita Electric Industrial Company of Osaka, Japan. I appreciate this opportunity to express our views on H.R. 2349. We submitted a lengthy written statement last June. Today, I will briefly highlight a couple of important points and will, of course, be happy to respond to your questions and concerns.

While we are aware of the concerns regarding the current trade balance with Japan on goods, let me emphasize at the outset that this particular bill will not reduce imports from Japan. It will not improve the trade picture nor increase purchases of U.S.-made picture tubes. Rather, its effects will most likely be the opposite and will be felt directly at our plant in Franklin Park, placing at risk American jobs in Illinois. This adverse impact on American jobs and also investment in Illinois is clearly not what the bill was intended to accomplish, but nevertheless that is exactly what it will do. However, it takes a little explanation about our business to understand why this is the case. I assure you, the issue before you is not helping American companies compete against Japanese companies. Rather, it is whether there will be a reversal of long standing, valid Customs rulings and policy to the detriment of the American color television industry, and specifically the workers, investment and community at our facility in Franklin Park, Illinois.

In order to better comprehend these adverse effects, let me first tell you a bit about MIC and our facility in Franklin Park. We produce about 55% of the color televisions marketed for U.S. consumption under the Panasonic label and over 80% of those sold under the Quasar label. And when I say "produce," I mean that we are the major part of a multi-step manufacturing process. We are a design, engineering, assembly, and distribution facility. We employ about 1400 workers, who are skilled, dedicated employees, averaging some 12 years of work at our facility. Among our activities is to bring together parts and components which are manufactured by various companies in the United States and in other countries in a sophisticated assembling and testing operation. We believe that our facility is among the most modern and efficient in the world.

We buy approximately $70 million worth of parts and components from U.S. vendors, in addition to about $40 million in color picture tubes purchased from U.S. suppliers. We use parts produced in our sister company's plant in Tennessee. We also use circuit boards, chassis, and control panels assembled at our Tijuana, Mexico plant. Some of those items are imported in shipments with "matched" color picture tubes, which are produced in Japan. These matched units are the subject of this bill, and I have come to learn that the Customs law classifies them as "color television assemblies having picture tube."

The issue at hand is the duty on color picture tubes that are imported as part of "assemblies." MIC obtains approximately half of its picture tubes for the televisions it produces in Franklin Park through such "assembly" imports, which are dutied at 5%. This is the same duty as is applied to completed color television sets. Color picture tubes which are imported alone carry a 15% duty. The bill that is before you would increase the duty on the picture tube portion of "assemblies" from the Mexican part of our operation from 5% to 15%. Our written statement explains the legal background of this duty situation, including the fact that the essential elements of the "assembly" duty rate, upon which our present operation in Franklin Park is based, date back to 1967 and that there were five specific Customs rulings on this issue before 1981, when MIC sought and obtained the ruling concerning its shipments from Mexico.

For my purposes, as a businessman, the issue has always been how to make our plant operate in the most efficient, profitable way and expand its capabilities in this highly competitive marketplace. From the beginning of Matsushita's ownership of the Franklin Park facility in 1974 until 1982, we bought nearly all of our picture tubes from the four U.S. producers of those tubes, with whom we also compete in the consumer marketplace--Zenith, RCA, GE, and Philips. Our very existence was threatened in 1981 and 1982, however, when we faced another major price increase, bringing the total increase on picture tubes to 30% over 1979 levels, from those domestic suppliers. These four manufacturers have been, as you know, the giants in our industry and have consistently been four of the top five in consumer sales of completed sets. Because, as you know as consumers, the price for completed color television sets remained essentially stable over many years, we could not pass on the huge picture tube price increases to our customers. To simply absorb the increase was also out of the question, because the color television industry has always been a highly competitive, low margin business, and the picture tube makes up one quarter to one third of the cost of a completed set. Continuing to sustain this cumulative 30% increase in picture tube costs would have meant either massive sales losses or the elimination of any hope of profitability for our facility.

We could have simply closed the doors in Franklin Park, and moved our production to Mexico, where we already had a facility. But we did not do that. Instead, in accordance with our overall corporate goal of rapidly expanding domestic production, we continued to make substantial investments at the Franklin Park location. We did this in a number of ways, including installing what we call state-of-the-art "Super Lines," increasing worker training, and instituting an on-going effort to hold the line on all of our costs, especially picture tube costs. A vital part of that effort was the Customs ruling we obtained in 1981, which confirmed the prior Customs rulings I referred to earlier, that the duty would be 5% on imports of chassis, control panels, and picture tubes from our Mexican facility.

As I understand it, the Customs Service considered our partiuclar ruling request very carefully, actually making four separate decisions as part of its administrative process. On each occasion, Customs held that the 5% duty was the proper duty for our shipments. The last Customs ruling, in November 1984, was in response to a petition by domestic labor unions seeking to have the Customs rulings reversed to raise the duty. This ruling has again been challenged by the unions in an action in the U.S. Court of International Trade, where it is now pending. Passage of this bill, however, would take on-going consideration of this question away from the courts.

Having obtained this ruling and relying upon it, we proceeded to expand our modernization program, and I am proud of the improvements that we have achieved. Our plant is now efficient and profitable, and we have increased our work force from 1100 in 1982 to nearly 1400 today.

All of this, however, is now threatened by H.R. 2349. In today's competitive environment, we could not afford to pay the increased duty that passage of this bill would impose on my operation and maintain our Franklin Park facility. One of our investments, the multimillion dollar investment in "Super Lines," was made for the purpose of reducing our cost of production by about 1%. This bill would, in one stroke, increase our costs for the sets involved by over 3%. Although we have announced small price increases for 1986, after a year when prices for completed television sets actually declined, we simply cannot further increase our prices.

The bill itself really suggests what we could do if it passed. Since completed television sets are presently dutied at 5% and are expected to continue at that rate, MIC would be forced to examine very seriously the option of expanding our Mexican operation to make completed sets, not merely components. If we were to move this way, the losers would be those of us who work and have put so much effort in Franklin Park. In addition, Mexican assembled sets would also probably contain an even higher percentage of Japanese-made picture tubes than we now have in sets made in Franklin Park. Thus, U.S. sales of picture tubes would not gain at all, and would probably lose. Further, our domestic suppliers of parts and components other than picture tubes, which we now buy for use in Franklin Park, would lose in a big way--perhaps amounting to as much as $70 million in sales.

Let me spend a minute more to explain what our current picture tube purchasing policy is and why it is the way it is. First, we now buy and will continue to buy about 50% of our picture tube needs from U.S. producers. This is both a company policy associated with our desire to be a truly American producer and a practical business policy based on the concerns that foreign made picture tubes are not available on as flexible a basis and that there could be temporary disruptions in supply from overseas, due to transportation delays or the like. Second, we will not increase our purchases of U.S.-made picture tubes above a certain level because of our concern that prices could rise sharply again, as they did in 1979-81, and because we have decided that it is not healthy to be totally dependent on our major completed-set competitors for the most vital component of our sets. Third, we have found that the production line defect rates for U.S.-made picture tubes are 2 to 8 times higher than that for our Japanese-supplied tubes. While we have worked hard with our U.S. suppliers and some of them have improved significantly, we remain convinced that we should not be solely dependent on picture tubes which cause us these levels of production problems.

In sum, I would only reemphasize that this bill, which at first appears to be either an arcane change in Customs law or a pro-American trade bill, is, upon careful analysis, neither of these. Its real world impact is difficult to analyze unless you are part of this industry and familiar with its actual operations. I am in my 35th year in this domestic television industry and firmly believe that, in reality, this bill would very substantially disrupt the functioning of my American television producing facility, to the jeopardy of that facility, our workers, and our community. I, therefore, urge you not to approve H.R. 2349.

Thank you. I will be glad to answer any questions you may have.

Mr. **Pease**. Thank you, Mr. Kraft.

Mr. Guarini.

Mr. **Guarini**. Thank you, gentlemen, for your fine testimony.

I was very interested in one statement that was made, Mr. Pearlman, by Mr. Kraft. It was to the quality of the American workmanship, and we have always been considerably upset about that in our trade competitiveness. Is it a fact from your statistics that the defects of the television sets, the television tubes that are made here, are 2 to 8 times as much defective than what they find from Japan?

Mr. **Pearlman**. Our statistics would not bear that out.

Mr. **Guarini**. What are your statistics?

Mr. **Pearlman**. We don't buy any Japanese picture tubes to use in our own lines. Our own defect statistics in terms of units that result in defects in the assembly process are a very very small fraction of 1 percent, and the customers to whom we sell on the outside who buy from multiple sources report to us at the present time our quality is equivalent to any tubes they are buying around the world.

We do buy some Japanese picture tubes for computer displays, and depending on the vendor from whom we are buying, we have had very wide ranges of defects, some as high as 50 percent.

Mr. **Guarini**. So therefore you don't feel there is a quality gap between what you produce and what——

Mr. **Pearlman**. No, I do not. It is a worldwide industry, and you have to be a world player to stay in and be competitive.

Mr. **Guarini**. Quality is certainly one of the real problems that exists out there when you talk about competitiveness.

Mr. **Pearlman**. I would point out also, in the submitted testimony by Toshiba, they indicate they buy picture tubes in the sizes available in the United States all from U.S. suppliers. I am sure that they have a very good measure of quality in that they indicate they buy them from U.S. suppliers because they are cheaper and because they save freight and duty and have a lower inventory level and short in delivery time. And I think that since they are one of the three or four largest producers in the world, that would speak highly to all of the factors of competitiveness.

Mr. **Guarini**. Do you take any objection to any of the testimony given by Mr. Kraft?

Mr. **Pearlman**. I tried to introduce information on the pricing since 1979 to indicate our pricing in the industry is about 10 percent lower than it was in 1979, and the prices continue to be pushed down by the imports from Korea and Singapore.

This import business under this loophole has exploded this year, and I think the other exceptions were probably covered in my oral testimony.

Mr. **Guarini**. How much cost, Mr. Kraft, does this create if they go from the 5 to 15 percent in your company?

Mr. **Kraft**. If we were talking about a picture tube such as just described, if the price were in the $65 range, you are talking $6.50.

Mr. **Guarini**. Take your company, which would create revenue for the United States, how much money are we talking about here?

Mr. **Kraft**. In total revenue to the U.S. Government?

Mr. **Guarini**. Yes.

Mr. **Kraft**. I think you have to be careful when you talk about revenue to the Government because what you want to know is what impact passage of the bill will it have, how much does it raise the revenue.

Mr. **Guarini**. How much does it mean to your company, the difference between the 5 and 15 percent, with the way you operate today.

Mr. **Kraft**. If we were to continue to operate the way we operate today, it represents about 10 percent of our purchases from Japan, which is about $3½ million.

Mr. **Guarini**. And how much gross does your company do per year? How big is your company gross-wise?

Mr. **Kraft**. Our gross sales are in the range of $400 million.

Mr. **Guarini**. So it would be less than 1 percent of the entire gross sales?

Mr. **Kraft**. Of our gross sales. That is including microwave ovens and other products also.

Mr. **Guarini**. Does it affect any other companies other than your company? Are there other similar situations that exist in this country?

Mr. **Kraft**. I understand there have been other filings that have been made. I am not familiar with the situation of other companies.

Mr. **Guarini**. Now, your company, is it a joint venture or owned 100 percent?

Mr. **Kraft**. It is fully owned.

Mr. **Guarini**. So you are a subsidy?

Mr. **Kraft**. We are a division, yes.

Mr. **Guarini**. Your subsidiary in Tijuana, is that owned completely or——

Mr. **Kraft**. It is owned completely by our company. It is a division of MECA, our U.S. headquarters, and is operated as a division of Matsushita Industrial Co., our company.

Mr. **Guarini**. So it is not a matter of being owned by Mexican——

Mr. **Kraft**. No, sir. It is 100 percent owned by us. One comment also about the quality issue. I did not talk about Japanese quality in general because, frankly, I don't know about it. However, I do know about the quality of the tubes we buy from our parent company, and I can tell you that the facts I gave you are fact.

Whether Mr. Pearlman believes them or understands them, they are fact.

Mr. **Guarini**. Well, you say you buy about 40 million dollars' worth of parts and 70 million dollars' worth of tubes. So about one-quarter of your gross you buy American; the other three-quarters of your operation is either Mexican or from the Far East; is that correct?

Mr. **Kraft**. If we look——

Mr. **Guarini**. Let me ask another way. Just so I may have a better insight into your operation, what do you actually import from Japan?

Mr. **Kraft**. We import picture tubes plus certain critical semiconductor components, leadless resistors, capacitors—there are a few other parts also. We import from Japan, Singapore, Malaysia and, of course, we buy in the United States. If we look at our total material cost for our company, our split between domestic and foreign is approximately 50/50.

Mr. **Guarini**. And you assemble basically everything here?

Mr. **Kraft**. We assemble in Tijuana, Mexico, or in Franklin Park or both together.

Mr. **Guarini**. All your products are sold in the domestic markets of the United States or do you export from the United States?

Mr. **Kraft**. Actually we export chassis also to Canada, but basically North America is our market.

Mr. **Guarini**. Thank you.

Mr. **Pease**. Thank you, Mr. Guarini. I have some questions as well.

What is the duty on finished TV sets?

Mr. **Kraft**. Five percent.

Mr. **Pearlman**. Five percent.

Mr. **Pease**. Five percent on unfinished TV receivers; is that correct?

Mr. **Pearlman**. Under the current interpretation, it is 5 percent on complete receiver kits. The interpretation would indicate that a product qualifies as complete if it has one large circuit board and a picture tube. Our view is it wouldn't be a complete receiver, but that is getting treatment as if it is a complete receiver.

Mr. **Pease**. I see. The picture tubes, that is 15 percent, right?

Mr. **Kraft**. Yes.

Mr. **Pease**. OK. Mr. Pearlman, I can understand why Mr. Kraft might be nervous about buying picture tubes for his TV sets from the people who compete with him at he retail level.

Mr. **Pearlman**. I am not nervous about buying semiconductors from his parent, which I do on a regular basis, and from other people with whom I compete. I am not nervous about buying components from RCA or G.E. There is a very very long history of making certain that in times of shortage which, frankly, there have been very few of, that there is fair allocation amongst all customers.

Mr. **Pease**. What about price? Is there any differentiation pricing at all back, say, prior to 1981 where you were supplying a picture tube to your own assembly operation at a lower price than you were supplying them to Mr. Kraft's operation?

Mr. **Pearlman**. All our arm's length transactions would be at supportable competitive and comparable prices. We don't happen to sell within our company picture tubes to our own operation. They are the same company.

Mr. **Pease**. Mr. Kraft, would you comment on that question?

Mr. **Kraft**. The fact is a picture tube is an internal transaction inside Zenith. What it costs and how the profit is distributed is just not visible. All that is visible to me is the cost that I have to pay.

Mr. **Pearlman**. I should interject one other thing, if I may, and that is at current prices, at this $65 price level, I mentioned for one screen size and the larger and smaller tend to sell for more or less dollars. If we were transferring back and forth to ourselves at that price, we would be losing money in the picture tube business.

Those are not prices that cover full costs for us.

Mr. **Pease**. Mr. Kraft, do you feel that you were at any disadvantage price-wise in 1979 and 1980 for having to purchase your tubes from your competitors?

Mr. **Kraft**. I feel that I was put under a great deal of pressure profit-wise, yes, because the price of the picture tube rose dramatically. The market pricing for receivers from these same companies did not, and that squeeze showed up as a significant profit problem for me.

Mr. **Pease**. Mr. Pearlman, why in your opinion, did the price of tubes go up significantly during that period?

Mr. **Pearlman**. I think it was artificially depressed from too much competition at the beginning of that period, and also at that time the cost of glass—which is the major component of the picture tube cost at almost 50 percent of the total cost of the picture tube—the cost of glass to the tube makers went up very sharply, and so you had pass on in glass in an attempt to recover some margin through pricing.

It didn't work. It didn't stay.

Mr. **Pease**. OK. If this legislation were to become law, would either of you expect the companies that are currently importing these picture tube assemblies to then source domestically or would they move offshore to produce the finished sets?

Mr. **Pearlman**. I think Dick and I are going to disagree on this, but I believe that some of the volume that has moved offshore would in fact come back. Some of it threatened to move offshore will not move because very large screen picture tubes are not economical to transport from the Far East. And, in addition, by passing this legislation, a great deal of picture tubes sold in the United States right now will stay here.

There are importer assemblers who are looking at this legislation very carefully now, and are making their plans to avail themselves of the loophole if it is not closed. And they are buying upward of 2 million picture tubes a year. That is essentially one more of the five plants that are still operating.

Mr. **Pease**. Mr. Kraft?

Mr. **Kraft**. Again, I have no visibility about these other competitors. Perhaps Jerry knows better. But from our viewpoint it is clear which way we have to go. We are examining very, very deeply, as I explained in our presentation, the concept of moving a great deal of our finished goods production into the Mexican border area, since there is no question the appears about the future direction for duty on finished goods. And, if the bill is enacted, we will in fact build significant numbers of finished goods in the Mexican border area to the detriment of Franklin Park.

Mr. **Pearlman**. With the yen of 191 as one hypothesis, and the yen of 170 as another hypothesis, taking the Toshiba statement sitting on the table, saying they would presently buy U.S. tubes because of cost and the 5-percent loophole is available to them. I would say as the yen continues to strengthen, U.S. industry will have a fighting chance to supply those tubes even if the final assembly is in Mexico.

Mr. **Pease**. Tell me what it is, Mr. Kraft, that you do in Mexico currently. The picture tube comes into Mexico and then something crosses the border into the United States, what is it you actually do to it between the time you get the picture tube in Mexico and the time you ship it across the Mexican border?

Mr. **Kraft**. We described that very clearly in our presentations before, and in the four times we went through these discussions with Customs. The picture tubes go across the border to our plant in Tijuana where they are matched with chassis, control panels and other subassemblies to make an assembly with picture tube.

Now, they are not physically connected together at that point, as we have described consistently from the beginning. For reasons of shipping protection, we ship them separately, but in the same truck and with the chassis corresponding to them.

Mr. **Pease**. So the picture tube is still all by itself, just like it came from Japan; is that correct?

Mr. **Kraft**. That is correct.

Mr. **Pease**. That doesn't sound like substantial transformation to me.

Mr. **Kraft**. I don't know what that is, frankly, myself. But what I do know is that this has been clearly understood and has been examined a number of times. There is a long history of consistent interpretation of the law in this way.

Mr. **Pease**. What do you mean by matching the products? You say picture tube 101 is going to be with chassis 110, and so on, or do you just take 100 picture tubes and 100 chassis and send them in the truck and say you have matched them?

Mr. **Kraft**. As we have described numerous times before, we put a comparable quantity of picture tubes and chassis of a matched type—I mean we have different types of picture tubes used with different chassis, but we put the same types together in the same truck, in equal numbers, and we control them through our production lines together.

Mr. **Pease**. I see.

Mr. **Guarini**. If you would yield for a moment, the fact that they are supposedly shipped together is a fix that they are attached. They are really not attached, so therefore there is in a sense a loophole that is involved here because you are using the packaging and transporting method as a way of getting lower tariffs.

That is what it seems to me, sir.

Mr. **Kraft**. Well, my understanding——

Mr. **Guarini**. Why should there be a lower tariff?

Mr. **Kraft**. I don't write the laws. My understanding is that we have the perfect right to utilize the law to our best advantage.

Mr. **Guarini**. Absolutely. But the question is should there be a difference? If you were sitting up here and we were sitting down there, how would it look to you to say we have been able to find a way of getting around, paying the Government their just tariffs because we have found a transportation mode that we can satisfy the U.S. Government.

Mr. **Kraft**. I look at it just a little bit differently than you do. I look at it as a way of utilizing that law to keep the factory going in Franklin Park, to keep 1,400 people employed making television sets that I may not be able to keep employed if this law is passed.

Mr. **Pease**. Mr. Kraft, thank you for that reply, and Mr. Pearlman and Mr. Guarini, we only have about 2½ minutes to vote. I would like to thank both of you gentlemen for your testimony.

We are going to declare a recess for 4 or 5 minutes, and then we will call our next panel. Thank you.

[Recess.]

Mr. PEASE. The subcommittee will reconvene.

Mr. Guarini and I both have considerable interest in hearing what the Customs Service has to say about the bill that we have been discussing. The person who is knowledgeable on that bill is on his way here. I think we will move on to the next set of bills and then hear from that witness from Customs when he arrives.

So at the moment we will move on to H.R. 2354, 2396, 2849 relating to motor fuels, motor fuel blending stock and napthas, et cetera, and we will hear from a panel of two witnesses, Mr. Ray Bragg, Jr., executive director, American Independent Refiners Association, representing the Independent Refiners Coalition; and the Society of Independent Gasoline Marketers of America, represented by Mr. Normal Potter, senior vice president, Warren Petroleum Co.

If you two gentlemen would take your seats, and we will hear first from Mr. Bragg.

STATEMENT OF RAY F. BRAGG, JR., EXECUTIVE DIRECTOR, AMERICAN INDEPENDENT REFINERS ASSOCIATION, ON BEHALF OF THE INDEPENDENT REFINERS COALITION

Mr. BRAGG. Thank you, Mr. Chairman.

My name is Ray Bragg. I am executive director of the American Independent Refiners Association, and I am testifying today on behalf of the Independent Refiners Coalition. The coalition is composed of 17 companies in addition to the trade association. The IRC represents altogether 34 independent refiners which operate approximately 40 percent of the independent refining capacity in the United States. The independent refining sector represents about one-third of U.S. operating refining capacity.

Because of the concerns and problems the refining industry is facing, and it has presented to this committee in great detail over the last 2 years in terms of testimony and written comments on this issue, as well as H.R. 2451, my comments today will be brief and to the point.

The independent U.S. refining industry is currently in an extremely difficult competitive position. The survival of this important domestic industry is seriously threatened by an alarming increase in imports of gasoline and other petroleum products. These imports adversely affect the entire U.S. refining industry. However, the impacts are most severe and immediate on the vital independent sector of the industry.

Mr. Chairman, the last Congress considered and rejected legislation to change the existing tariff treatment of gasoline blending materials. Instead, Congress concluded that a comprehensive approach dealing with all motor fuels was a more appropriate way to proceed, and the matter was referred to the International Trade Commission [ITC]. In response to this congressional request, the ITC issued a study last April recommending a streamlined classification system using an actual use test to provide stronger enforcement.

The study also noted that the OPEC nations are expected to increase their refining capacity by 2.9 million barrels per day by 1987, and that these nations have a competitive advantage in the production of petroleum products because of their assured low-cost supply of raw materials.

Following the issuance of this study, Congressman Anthony and Duncan introduced their bill, H.R. 2354, which adopts the classification and enforcement recommendations of the study and updates the tariff on motor fuel to address the recent increase in imports and the threat of further increases. The Anthony/Duncan bill would establish a uniform ad valorem duty of 10.8 percent on motor fuel and motor fuel blending stocks, and would apply an increased ad valorem tariff to annual imports in excess of 3 billion gallons. The first tier duty would update the tariff treatment of motor fuel to take into account more than 25 years of inflation. When the existing duty of 1.25 cents per gallon was first established in 1958, wholesale gasoline prices were about 11.5 cents per gallon. Though gasoline prices have multipled, the duty has never been revised.

The second tier tariff is designed to discourage motor fuel imports in excess of the level which has historically been acceptable in terms of national security. As shown in a study recently prepared by Dr. Charles Ebinger of the Georgetown Center for Strategic Studies for the Independent Refiners Coalition, the United States has already lost the refining capacity it needs to respond to an international crisis.

I would like to submit at this time a copy of that statement for the record.

Mr. PEASE. That shall be done.

Mr. BRAGG. The IRC commends Mr. Anthony and Mr. Duncan for their thorough and well-considered approach to this serious national problem, and we are pleased to support their bill. However, the coalition must oppose the bill by Mr. Matsui, H.R. 2396, which is also pending before the subcommittee. Mr. Matsui's bill attempts only to change the classification of motor fuel blending materials and to give them the benefit of the minimal outmoded tariff on motor fuels. It does not address the comprehensive classification of motor fuels and blending components or apply the actual use enforcement mechanism to categories other than blending stocks.

This ad hoc approach to blending materials is comparable to the legislation which was considered and rejected by the last Congress and should be regarded as a step in the wrong direction.

Mr. Chairman, that concludes my remarks.

[The prepared statement and attachment follow:]

STATMENT OF RAY F. BRAGG, JR.
ON BEHALF OF
THE INDEPENDENT REFINERS COALITION
BEFORE THE
SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

February 6, 1986

Mr. Chairman and Members of the Subcommittee:

I am Ray Bragg, Executive Director of the American Independent Refiners Association (AIRA). I am testifying on behalf of the Independent Refiners Coalition (IRC). The IRC is composed of 17 companies and the American Independent Refiners Association, a trade association. The IRC represents 34 independent refiners which operate approximately 40 percent of the independent refining capacity of the United States. The independent refining sector represents about one-third of U.S. operating refining capacity.

The independent U.S. refining industry is currently in an extremely difficult competitive position. The survival of this important domestic industry is seriously threatened by an alarming increase in imports of gasoline and other petroleum products. These imports adversely affect the entire U.S. refining industry. However, the impacts are most severe and immediate on the vital independent sector of the industry.

Mr. Chairman, the last Congress considered and rejected legislation to change the existing tariff treatment of gasoline blending materials. Instead, Congress concluded that a comprehensive approach dealing with all motor fuels was a more appropriate way to proceed, and the matter was referred to the International Trade Commission (ITC). In response to this Congressional request, the ITC issued a study last April recommending a streamlined classification system using an actual use test to provide stronger enforcement. The study also noted that the OPEC nations are expected to increase their refining capacity by 2.9 million barrels per day by 1987, and that these nations have a competitive advantage in the production of petroleum products because of their assured low-cost supply of raw materials.

Following the issuance of this study, Congressmen Anthony and Duncan introduced their bill, H.R. 2354, which adopts the classification and enforcement recommendations of the study and updates the tariff on motor fuel to address the recent increase in imports and the threat of further increases. The Anthony/Duncan bill would establish a uniform ad valorem duty of 10.8 percent on motor fuel and motor fuel blending stocks, and would apply an increased ad valorem tariff to annual imports in excess of three billion gallons. The first tier duty would update the tariff treatment of motor fuel to take into account more than 25 years of inflation. When the existing duty of 1.25 cents per gallon was first established in 1958, wholesale gasoline prices were about 11.5 cents per gallon. Though gasoline prices have multiplied, the duty has never been revised.

The second tier tariff is designed to discourage motor fuel imports in excess of the level which has historically been acceptable in terms of national security. As shown in a study recently prepared by Dr. Charles Ebinger for the Independent Refiners Coalition, the United States has already lost the refining capacity it needs to respond to an international crisis. Contrary to the complacency shown by many observers, Dr. Ebinger's study shows,

> The issue in the 1970s was obtaining needed crude oil imports to ensure U.S. and allied security...
>
> In the 1980s a new problem has arisen. While the U.S. and its allies have reduced their crude oil import dependence, particularly from potentially unstable sources, some refined product imports have increased significantly. Of particular consequence to the U.S. refining industry is the increase in imports of gasoline and gasoline blendstocks. Every barrel of imported gasoline displaces the need for about two barrels of domestic refining capacity...As refined product imports increase, U.S. capacity to refine crude oil decreases, and the crude oil safety net unravels.

With the Chairman's permission, we would like to offer a copy of the study for the record.

The IRC commends Mr. Anthony and Mr. Duncan for their thorough and well-considered approach to this serious national problem, and we are pleased to support their bill. However, the Coalition must oppose the bill by Mr. Matsui, H.R. 2396, which is also pending before the Subcommittee. Mr. Matsui's bill attempts only to change the classification of motor fuel blending materials and to give them the benefit of the minimal outmoded tariff on motor fuels. It does not address the comprehensive reclassification of motor fuels and blending components or apply the actual use enforcement mechanism to categories other than blending stocks. Thus, the Matsui bill only partially responds to the ITC study and would have a net effect of encouraging the increase in imports. This ad hoc approach to blending materials is comparable to the legislation which was considered and rejected by the last Congress, and should be regarded as a step in the wrong direction.

In conclusion, Mr. Chairman, we are pleased to offer our support for H.R. 2354, and must record our opposition to H.R. 2396.

OIL PRODUCT IMPORTS:
A THREAT TO U.S. NATIONAL SECURITY

A Report of

EBINGER INTERNATIONAL

Charles K. Ebinger
President

This report was prepared by Charles K. Ebinger, President, Ebinger International, at the request of the Independent Refiners Coalition. Its conclusions represent the view of the author, and not necessarily the view of the Energy and Strategic Resources Program of the Georgetown Center for Strategic and International Studies.

FOREWORD

There is a controversy concerning the increasing level of light refined petroleum product imports coming into the United States. Some contend that imports are increasing due to free market forces, while others contend that imports are increasing because foreign government-owned or assisted refineries are obtaining crude oil at prices lower than U.S. refineries must pay in international energy markets.

The Department of Energy estimates that U.S. operating refinery capacity has fallen to 14.6 million barrels per day. This level of capacity invokes the question whether the refining industry could provide adequate supplies of light refined products for military and civilian use in the event of a military mobilization or a crude oil and refined product import disruption.

This study was commissioned by the Independent Refiners Coalition. Its purpose is to analyze the U.S. industry's ability to respond to a crisis today and in the future. It concludes that current operating refinery capacity is inadequate to maintain the national security of the United States and its allies; furthermore, that increased import penetration, particularly of gasoline and gasoline blendstocks, will cause a continued reduction of U.S. operating refinery capacity and escalate the threat to unacceptable levels. In the final analysis, this study concludes that the Reagan Administration and the Congress should launch a full-scale investigation and act promptly to alleviate the national security threat now posed by refined product imports.

EXECUTIVE SUMMARY

On January 14, 1975, Treasury Secretary Simon sent a memorandum to President Ford, pursuant to Section 232 of the Trade Expansion Act of 1962, declaring:

> As a result of my investigation, I have found that crude oil, principal crude oil derivatives and products, and related products from natural gas and coal tar are being imported into the United States in such quantities as to threaten to impair the national security...I therefore recommend that appropriate action be taken to reduce such imports...

On March 14, 1979, Secretary Blumenthal sent a similar memorandum to President Carter supporting his predecessor's conclusion and stating that it was "even more valid today."

The issue in the 1970s was obtaining needed crude oil imports to ensure U.S. and allied security. Sweeping measures were conceived to safeguard U.S. and allied interests, including the establishment in 1974 of crude oil sharing arrangements under the International Energy Administration (IEA), establishment in 1975 and ongoing buildup of the Strategic Petroleum Reserve (SPR), and conservation. These measures reduced consumption and provided a crude oil safety net to guard against the kind of disruptions which occurred in 1973 and 1979. By the end of 1985, the direct cost of oil and facilities of the SPR will reach $16.7 billion. But these strategies will fail to protect national security if crude oil cannot be refined into adequate supplies of usable fuels.

In the 1980s a new problem has arisen. While the U.S. and its allies have reduced their crude oil import dependence, particularly from potentially unstable sources, some refined product imports have increased significantly. Of particular consequence to the U.S. refining industry is the increase in imports of gasoline and gasoline blendstocks. Every barrel of imported gasoline displaces the need for about two barrels of domestic refining capacity. U.S refineries' major output is gasoline and profitability is based on gasoline sales. Since 1983, U.S. operating capacity has declined by at least 500,000 barrels per day (mbd) and operable capacity has declined by over 1.3 million barrels per day (mmbd). It is likely that most of current "operable" but idled capacity has been permanently closed, and that the remainder would require up to six months to return to operating status. The high cost of restarting refineries could not be justified economically to meet a shortfall of relatively limited duration. As refined product imports increase, U.S. capability to refine crude oil decreases, and the crude oil safety net unravels.

On August 8, 1985, 43 Senators - 22 Democrats and 21 Republicans -- sent a letter to Commerce Secretary Baldrige requesting a Section 232 investigation of the effect of petroleum product imports on the national security. Secretary Baldrige is now determining whether the investigation is necessary.

On the basis of what we know today, there is more than sufficient reason to proceed with the investigation. Imports of crude oil and refined products in 1985 are expected to equal the 1974 share of total U.S. oil demand which Treasury Secretary Simon found to be a threat to U.S. national security. Between now and 1990, the Energy Information Agency's (EIA) "base case" forecasts that crude oil and refined product imports will regain the 1978 share that Treasury Secretary Blumenthal found to be a more pronounced security threat in 1979. By 1995, EIA predicts that imports will exceed 52 percent of total U.S. demand, 5 points above the previous peak of 47 percent in 1977.

The United States and its allies cannot escape an increased dependence on imported crude oil from the Persian Gulf nations as we approach the 1990s. Falling crude oil production from higher-cost fields in the United States and other world regions makes this resurgent dependence unavoidable. In addition, any significant increase in refined product imports will also originate, either directly or indirectly, from Persian Gulf and other OPEC nations. While it is certainly in the United States' interest to maintain a broad strategic relationship with Persian Gulf and other OPEC nations, serious security questions are raised by escalating our energy dependence on these nations to include refined products.

As refined product imports increase, domestic refining capacity declines and we lose the capability to respond adequately to a number of contingencies. Figuring prominently among these contingencies is the possibility of a disruption in crude oil and product supplies from the Persian Gulf. A disruption could arise as the result of political, religious or military frictions which continue to destabilize the region.

The rapid increases in Middle Eastern and other OPEC nations' oil prices in the 1970s stimulated effective oil conservation measures in importing countries. Increased oil prices also resulted in increased oil production in many areas where higher costs had previously inhibited continued exploration, development or production; in addition, more nations entered international oil trade, diversifying the number of suppliers to import-dependent nations. The synergism created by these factors served to weaken the leverage exercised by Persian Gulf and other OPEC nations over the industrialized world's incremental oil supplies.

Between 1979 and 1984, oil imports plunged 40 percent in the United States, 36 percent in Western Europe and 26 percent in Japan. Crude oil official selling prices (OSPs) have fallen from $34 per barrel to current levels of around $28 per barrel, with lower prices possible in the near future. Price decreases have not ensued without significant costs, however, including the closing of 7 - 7.5 mmbd of refining capacity worldwide. Lower prices for oil have also affected new exploration and production in the higher-cost recovery regions such as Alaska and the North Sea. Between 1963 - 1973, world oil production grew by 25.5 mmbd at a cost of $76.2 billion ($3,000/bbl of productive capacity). In contrast, between 1973 - 83, world oil production grew by 6 mmbd at a cost of $420 billion ($70,000/bbl of productive capacity). Plainly, oil is becoming more expensive to find, risks are increasing exponentially and less is being found. Yet, if projects are not being developed today, they will not be producing by 1990.

U.S. operating refining capacity has undergone a reduction of 3.5 mmbd since 1981. Much of this reduction through 1982 was caused by the end of oil controls and may be ascribed to market forces. However, shutdowns after 1983 are directly linked to increased product import penetration, particularly increased gasoline and blendstock imports.

The refining industry today, with operating capacity of 14.6 mmbd, would be inadequate to respond to a military mobilization involving U.S. and NATO forces. Crude oil stockpiles cannot serve their purpose if there are not enough refineries to use them. Any further reduction in capacity would directly imperil U.S. and allied security.

Under current conditions, this reduction is inevitable. OPEC nations have moved downstream into the construction of refined product export capacity. Despite the fact that lower crude oil prices, high construction costs and high transportation costs have rendered the new OPEC export capacity uneconomical for years to come, OPEC crude oil subsidies will ensure its utilization and the ability of OPEC producers to penetrate the U.S. refined products market. This, in conjunction with the proliferation of OPEC-supported processing and netback deals with foreign refiners and re-export deals with the Soviet Union, has generated a hidden dependence on OPEC crude oil in product form. Because U.S. tariff and non-tariff barriers to the importation of gasoline are much lower than their counterparts in Europe and Japan, refiners with excess capacity find the U.S. market an attractive target.

The Pace Company of Houston, Texas, an energy economics analysis firm, reports that the OPEC nations will bring onstream 1.9 mmbd of new export capacity by 1988. Pace estimates that this new OPEC capacity could displace up to 1 mmbd of U.S. refinery capacity by 1987 and up to 1.4 mmbd by 1990. In addition, the Environmental Protection Agency's (EPA) acceleration of lead phasedown requirements provide refiners in Europe, Canada and Venezuela with a temporary, artificially created advantage to export unleaded gasoline to the United States. The ability of these foreign refiners to continue to meet domestic octane requirements with higher lead levels frees them to export high-octane materials to the United States as unleaded gasoline. Furthermore, much of the incremental supply of unleaded gasoline from Europe and some from Eastern Canada is dependent on crude oil supplied by Organization of Arab Petroleum Exporting Countries (OAPEC). This OAPEC crude dependence makes the availability of such gasoline exports to the U.S. doubtful in the event of a disruption of oil supplies from the Middle East. Such imports cannot be depended upon in a national security context any more than direct product imports from OAPEC export refineries.

The vulnerability of petroleum production, refining and transportation systems in the Persian Gulf and North Africa raises troubling questions regarding the wisdom of combining enhanced petroleum product dependence with increased crude oil dependence on the region. The destruction of the giant Abadan refinery in the Iran - Iraq war, the unsuccessful attempt by Shiite terrorists to blow up the Shu-aiba refinery and petrochemcial complex in Kuwait in December 1983, the destruction of a significant portion of the giant Kharg Island facility in Iran in 1985, continued attacks on oil tankers in the Gulf, the planting of mines in the Red Sea -- a vital oil product sea route -- and the sabotage of oil pipelines throughout the region argue strongly against a complacent view of the political stability of this region.

In its contribution to the 1979 assessment of Secretary Blumenthal under Section 232 of the Trade Expansion Act, the CIA warned of the numerous threats that could be posed to oil supplies:

> There are a number of territorial and political disputes involving Middle Eastern oil exporting nations that could escalate to armed conflict, including insurrections, guerrilla wars and more conventional wars.

These assessments were echoed by Secretary Weinberger in his 1986 fiscal year authorization to the Congress:

> Causes of instability and conflict...are many: ethnic and religious cleavages, irredentism and territorial disputes, rivalries for regional power and domination, and economic fluctuations and grievances. Although many of these problems are rooted deep in the past...they have been exacerbated by the proliferation of technologically advanced weapons systems, and above all, by increased Soviet suport -- both direct and through proxies -- for terrorism, insurgency and aggression.

The Joint Chiefs of Staff, in its 1985 report on the current state of our global military posture, said:

> Threats to the stability of [the Middle East and Southwest Asia] are numerous and complex. Local disputes, fueled by religious and nationalist differences and complicated by social and political changes, have drawn many regional factions into armed conflict ...Serious differences remain among factions in Lebanon. If not resolved, these differences could lead to even greater tensions in the region. In the Persian Gulf area, the Iran - Iraq war continues. This war could increase in intensity and scope, thus endangering other Gulf states and oil fields and threatening free passage through the Strait of Hormuz...

These concerns were reiterated by former Secretary of State Kissinger. According to Dr. Kissinger, if Iran were to win the war with Iraq, the consequences for oil supplies and prices would be incalculable:

> Iran especially would not hesitate to impose on a defeated enemy and its impotent neighbors the production cutoff that it accepted for itself in the 1970s. It would thereby achieve unilaterally what it has been urging on OAPEC for years: sharply reduced production, greatly increased oil prices and a blackmail position vis a vis the industrial democracies...

The U.S. and other North Atlantic Treaty Organization (NATO) nations have a great stake in crude oil and refined product trade. While NATO planners note that NATO's overall dependence on the Gulf region has dropped from 31 percent in 1979 to 13 percent in 1983, they are disturbed that this trend reversed in 1984. Conversations with NATO and U.S. Department of Defense (DOD) officials make it apparent that military planners, especially in the U.S. Navy and Air Force and at NATO headquarters, are far from sanguine about the implications of increased Organization for Economic Cooperation and Development (OECD) import dependence on the Middle East projected for the 1990s. These planners, who must concentrate solely on military preparedness, often disagree with the public positions taken by their appointed superiors regarding the wisdom of increased import reliance, particularly on the Middle East.

Falling crude oil prices have severely affected the OAPEC nations, causing them to delay large public projects, in some cases, or alter plans to expand their industrial bases. Excess crude oil capacity and excess refinery capacity worldwide provide the OAPEC nations with a powerful incentive to engage in processing, netback and countertrade deals with foreign refiners outside the international market structure in order to move crude oil that cannot be sold at OSP or even at spot prices. These actions are among the most threatening to U.S. domestic refiners.

The existence of processing deals between OAPEC nations and key importing countries raises serious national security concerns. Of concern to domestic U.S. refiners is whether OAPEC governments are selling government-owned crude oil to their government-owned refineries at a cost below that charged to U.S. refiners either directly or through crude oil trading companies. Since the market price of OAPEC crude is above the cost of production (especially in the Persian Gulf, where crude oil production costs average less than $1.00 per barrel), OAPEC national oil companies can either subsidize the cost of the crude compared to the OSP or operate at a loss by allowing their highly-profitable production operations to offset refinery losses. The International Trade Commission (ITC) recently investigated the natural resource subsidy issue and discovered that many OAPEC nations sell oil to their refineries at prices ranging from $3.00 to $12.00 per barrel.

The situation is further complicated by the fact that several OAPEC nations have a wide variety of processing deals with refiners and marketers in the major oil importing countries which cannot compete by paying market prices for crude oil. Under one type of processing deal, the oil-producing nations pay a product refiner an agreed-to "processing fee" for converting crude oil to refined products and marketing them, even at depressed product prices, in lieu of selling crude oil to a refiner at current market prices. Libya, for instance, is engaged in netback deals with Italy, Greece, Turkey and Rumania. This practice boils down to more refined product imports from apparently "secure" sources which are themselves dependent on OAPEC crude oil.

Another way to mask OAPEC exports is the near-doubling since 1983 of Soviet re-exports of OAPEC crude to Western markets. In 1984, these re-exports rose nine times faster than net Soviet shipments of oil and refined products to the West, producing $3 billion or about one-fifth of Soviet oil earnings. The fact that Moscow can obtain this crude and reexport it at an apparent profit suggests that it was purchased for prices or on terms unavailable to U.S. and other refiners.

In order to protect national security, the U.S. refining industry must be able to:

- refine all domestic oil and natural gas liquid (NGL) production;
- refine uninterrupted crude import supplies;
- refine Strategic Petroleum Reserve crude oil in sufficient quantity to offset interrupted crude oil and product imports;
- refine the Strategic Petroleum Reserve at its full utilization rate to supply U.S. and NATO military needs in the event of a major crisis;
- ensure that the civilian economy will not have to reduce demand by more than 10 - 15 percent from pre-crisis levels in the event of military mobilization.

This study has determined that, at current levels of operating U.S. refining capacity, the requirements listed above cannot be met. Under current conditions, additional U.S. operating refining capacity will be displaced by increasing imports of light refined products during the next two years. This will further reduce our capability to meet even the most basic of these requirements -- the ability to refine domestic production and the SPR or its equivalent in crude imports.

The Department of Energy (DOE) reports that there are about 15.6 mmbd of U.S. operable refining capacity. This figure includes roughly 1 mmbd of capacity which is idle but "operable"; that is, according to DOE, capacity which could be restarted within 90 days. From a national security standpoint, reliance on the ability to restart the great majority of this capacity within 90 days fails to take into account that any disruption in supplies would be most traumatic in the early stages. Refiners discount DOE's 30 to 90 day restart timeframe as overly optimistic. Conversations with 10 oil companies indicate that no more than 300 mbd could be restored within 90 days. In a recent Senate hearing, a Texaco spokesman testified that, of all idle capacity, perhaps 600 mbd could be restored to service within six months and that this restoration would entail very high costs.

In conclusion, falling prices and the mirage of abundance have obscured the fact that crude oil and refined product imports have again risen to potentially destabilizing levels. Complacency regarding the level of refining capacity operating in the United States, under current conditions, cannot be justified. The United States and its NATO allies cannot avoid a resumption in increased crude oil import dependence on the Persian Gulf as we approach the 1990s. It runs counter to national security considerations to also become dependent on this volatile region for refined products like gasoline.

The Reagan Administration and the Congress should launch a full-scale investigation and act promptly to alleviate the national security threat now posed by refined product imports. A Section 232 investigation would lead to a firm determination of the capacity required for national security purposes. It is disturbing that, at this time, many government officials remain complacent about the level of capacity without knowing what that capacity should be, and with no framework to measure that required capacity level.

OIL PRODUCT IMPORTS:
A THREAT TO U.S. NATIONAL SECURITY

Introduction

Newspaper and magazine headlines about energy in 1985 have been dominated by the pending collapse of oil prices, the break-up of OPEC and the demise of the nuclear power industry. The price of crude oil has been falling, generating complacency among U.S. policymakers and consumers. But the good news about oil prices has served to mask a smouldering crisis. If ignited, this crisis could threaten U.S. domestic and international security as profoundly as the oil price and supply shocks of the 1970s. This crisis is the deteriorating state of the U.S. domestic refining industry, caused in significant part by the increasing volume of imported petroleum products -- especially gasoline and middle distillates -- from the Organization of Petroleum Exporting Countries (OPEC) and non-OPEC sources. An increased reliance on refined product imports, as opposed to crude oil, will close more U.S. refineries, directly threatening the energy security of the United States and its NATO allies.

Although current volumes of imported refined products -- 2 million barrels per day (mmbd) in 1984 -- appear small in relation to total U.S. product demand, these statistics mask a variety of changes occurring in international oil products trade that, if unanswered, threaten both the economic viability of domestic refineries and U.S. national security.

These changes are: 1) U.S. imported product demand has shifted from residual fuel oil from nearby refineries in the Carribbean to light petroleum products (gasoline and distillates) from Europe and the Middle East. Of special concern is the source of crude oil in European products which masks increasing U.S. dependence on Middle Eastern, North African and East Bloc crude oil; 2) the specter of rising U.S. import dependence on large export refineries located in politically-insecure areas of the world, such as the Middle East and North Africa; 3) the growing domination of international products trade by government-owned refineries which, for political reasons, are able to operate at marginal rather than average costs, placing private refiners at a disadvantage; 4) the proliferation of netback, countertrade and processing deals between oil-producing governments and overseas refineries which serve to provide crude oil at low prices not available to all other U.S.

and foreign refiners; and 5) changing U.S. environmental laws that place domestic refineries at a competitive cost disadvantage compared to their foreign competitors.

These market changes, examined in their totality, demonstrate an evolving vulnerability of U.S. refiners and the national security. Rising dependence on insecure sources of petroleum products is occurring against the backdrop of a projected increase in import dependence for crude oil from insecure Organization of Arab Petroleum Exporting Countries (OAPEC) sources over the next five to ten years. This presages that, by 1995, the United States will be dependent on imported crude and petroleum products for over 50 percent of total oil demand.

The current debate over the degree of threat posed by rising volumes of imported refined products centers on the fact that since January 1981, U.S. operating refining capacity has fallen by some 4 mmbd. Clearly, to the extent that further closings of U.S. refineries over the next two - three years occur as the result of the forces listed above, the U.S. will lose the flexibility to meet U.S. oil product demand in the event of a major oil supply disruption from the Middle East. The loss of this flexibility is a clear threat to national security.

PART 1: The U.S. and Global Refinery Industries

The decade of the 1970s was a tumultuous time for the domestic and international petroleum industries. During the 1960s and especially during the early 1970s, crude oil and petroleum product demand skyrocketed.

As 1973 commenced, the United States confronted the following situation. Domestic crude oil production had temporarily peaked in 1970 at 9.6 mmbd; by 1973 it stood at 9.4 mmbd. Imports of crude oil, which supplied 22.7 percent of U.S. demand in 1970, had risen to 35.9 percent. By April 1973, six months before the OAPEC embargo, gasoline shortages occurred owing to the Cost of Living Council's price controls on petroleum products and U.S. environmental regulations, which discouraged the construction of refineries in the United States.[1]

The oil price rises of 1973-74 and 1979-80 led to major changes in the way

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consumers used energy. These changes were slow to develop because government price controls effectively subsidized the price of oil to consumers. Government policies also protected U.S. refiners through an elaborate regulatory system and provided price incentives which led to the creation of scores of small inefficient refineries of less than 50 mbd.

While petroleum product demand slowed following the price shocks of 1973-1974, it grew once again between 1975-78 to a peak of 18.8 mmbd, up 13 percent since 1972. John Lichtblau, a leading petroleum consultant, notes in a recent Petroleum Industry Research Foundation (PIRINC) report that, following the Iranian crisis in 1979-80, the U.S. oil market was quick to adjust as the result of the removal of price controls between 1979-81 and a weakening U.S. dollar.[2] In response to these events, major changes in the oil product market occurred:

- Gasoline demand rose 13 percent between 1974 and 1978, then fell by 12 percent between 1978-82, before resuming growth at a slow rate;
- Distillate fuel oil demand, including diesel, hit 3.4 mmbd in 1978, then fell 22 percent before resuming modest growth in 1982;
- Demand for light products (which in 1985 account for about 80 percent of total product demand), fell 15 percent between 1978-82 -- posing major problems for all U.S. refiners, especially independents;
- Residual fuel oil, the largest imported petroleum product prior to 1973, fell between 1978 and 1984 by 45 percent under the impetus of conservation and the availability of other fuels in the industrial sector.[3]

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The change in the pattern of oil product imports is exhibited in the following table:

TABLE 1

U.S. PRODUCT IMPORTS BY TYPE, 1972-1984[4]
(Thousands of Barrels per Day)

	Kero & Jet Fuels, Gasoline & Distillates		Residual Fuel Oil		Others		Total
	Vol.	%	Vol.	%	Vol.	%	
1972	445	18	1,742	69	338	13	2,525
1978	460	23	1,355	67	193	10	2,008
1979	461	24	1,151	59	325	17	1,937
1980	372	23	939	57	335	20	1,646
1981	374	23	800	50	425	27	1,599
1982	331	20	776	48	518	32	1,625
1983	462	27	699	40	561	33	1,722
1984	630	32	674	34	675	34	1,979
Percent change per year 1978-84		5		(11)		23	-

In the United States, light products dominate petroleum product demand. Consequently, U.S. refiners have configured their refineries to produce light products which account for 80 percent of refinery output. In contrast, light products comprise only 65 percent of European refinery output and only 50 percent of Japan's. That is explained by the difference in product slates required in the different countries and also by the fact that, historically, U.S. refineries used light, low sulphur crude which yielded large volumes of environmentally clean products.

U.S. refinery economics are based on the production and sale of gasoline, distillate and other light products. U.S. gasoline demand in 1984 (6.7 mmbd) equaled 44 percent of global demand in comparison to 16 percent in Western Europe and 10 percent in Asia and the Pacific, including Japan. For this reason, in the late 1970s and early 1980s, as U.S. domestic oil production began to fall and the economics of heavy crude became more attractive, U.S. refiners began massive investments to upgrade their facilities to utilize lower-cost heavy, high sulphur crudes.

Between 1972-1980, U.S. refiners constructed 4.6 mmbd of new refining capacity under a mix of government and market incentives. At least 45 percent of these new refineries were built along the Gulf Coast.[5] At that time, all energy forecasts projected that demand for light products would increase. However, with oil price decontrol, and the reductions in global demand following the price shocks engendered by the 1979 Iranian revolution, demand declined.

It should be noted that even before U.S. oil price decontrol in January 1981, the worldwide recession, combined with rising oil prices, had led to a drop in domestic oil product demand. Overall, between 1978 and 1983, domestic oil product demand fell by 3.6 mmbd. This drop in demand forced the closing of many small, inefficient refineries that had been built or taken out of mothballs in response to favorable regulatory treatment in the 1970s.

Beginning in 1983 and continuing into 1984, domestic demand rebounded to 15.7 mmbd. Nonetheless, domestic refinery capacity continued to close down under the impact of rising volumes of imported light petroleum products, especially rising gasoline imports (up 400 mmbd between 1981-84 and an additional 30 percent through July 1985), corporate consolidations, declining refinery margins and more stringent U.S. environmental requirements.

By 1983, a profound change had occurred in the nature of oil product imports. As demonstrated in Table 1, rising volumes of light petroleum products created new problems for U.S. refiners. Whereas earlier refinery closings between 1978-1983 had predominantly been small inefficient refineries, highly sophisticated petroleum refinery capacity came under risk. The reason then, as now, is because U.S. refinery economics have been predicated on the profitable sale of gasoline to offset negative or smaller margins on less valuable products. Consequently, increased volumes of imported gasoline have posed a direct threat to U.S. refiners.

The reasons for this flood of gasoline are complex, but include: (1) excess refining capacity worldwide not rationalized to reflect the drop in world demand resulting in exports of surplus light products from

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European, Communist and Third World nations; (2) the emergence of new "dedicated" export refineries in the Middle East which, through a variety of mechanisms, can place U.S. refineries at a competitive cost disadvantage; (3) changes in the pattern of world refinery ownership away from private industry towards governments, with attendant government subsidies for oil product exports not available to U.S. refiners; (4) U.S. tariff loopholes that have allowed unfinished oils, gasoline blending components and naphthas to come into the market at tariff rates below the tariff rate for gasoline; (5) changing U.S. environmental requirements for lead phase-down, which have allowed foreign refiners to seize a short-term market opportunity to export their unleaded high-octane gasoline production to meet U.S. demand prior to refinery conversions or other lead phase-down alternatives being implemented by U.S. refineries; and (6) market aberrations caused by the British coal strike which led to an increase in surplus light products. The net result is that gasoline and gasoline blendstock imports may now account for at least 8-9 percent of U.S. gasoline demand.

While the rising volume of imported light products is a matter of financial concern to U.S. refiners, it is the source of these increasing imports that poses national security concerns for the U.S. Government. Throughout the late 1970s, 80-85 percent of the small volumes of light product imports coming to the United States originated from "short haul" sources in the Western Hemisphere, primarily from Venezuela and the Caribbean Islands. By 1984, this figure had fallen to 63 percent. Today it is 60 percent. Further declines are likely, especially in view of closings of major Caribbean refineries in the last several months. Likewise, in the late 1970s, the Virgin Islands and Puerto Rico, both U.S. territories, accounted for about 60 percent of light product imports, processed at that time from Venezuelan, Libyan, Algerian and other foreign crude oil. By 1984, this had fallen to 20 percent. In the case of the non-U.S. Caribbean refiners, light product imports fell from 15 percent in the late 1970s to 8 percent in 1984.[6] Only Venezuela and Canada, after sizeable investments in refining upgrading, have increased their combined share of light product imports to the United States, from 1 to 30 percent; Venezuela now ranks as the number one source of U.S. product imports.[7]

When examining oil product import statistics, an analyst has to be extremely careful because data gaps or varying accounting procedures can lead to skewed conclusions. For example, it is well known that a large volume of product exports that come to the U.S. from "Western European" sources are derived from East Bloc, OPEC and OAPEC crude oil. This is especially true of rising volumes of gasoline imports from Rumania, Italy, Turkey, and Greece (all using Libyan crude oil); Brazil (Nigerian countertrade deal), Algeria, the UAE and the USSR (reexport of OPEC crude and/or products derived from OPEC crude oil, and other non-OPEC crude oil, including Angolan).

U.S. Government reporting procedures add to the confusion. Whereas the Energy Information Administration (EIA) of DOE excludes the Virgin Islands, Puerto Rico and Guam from its compilations, the Commerce Department includes them. However, even here there are anamolies. While oil product shipments to these areas are counted as U.S. exports, crude oil imported by refiners on these islands for processing and reexport to the U.S. are not counted as U.S. imports. While the U.S. Government attempts to justify its procedures by noting that the Virgin Islands refinery currently processes a large volume of Alaskan crude oil, this can readily change in response to market conditions. Puerto Rico, in contrast, processes a blend of crudes from Venezuela and other OPEC and non-OPEC sources. These statistical procedures thus cannot only mask the real level of refined product imports but also the source of crude used to refine those imports.

This problem of identifying the source of crude feedstocks in imported petroleum products will increase as government-owned or government-controlled refineries gain greater penetration of the U.S. and world markets. Whereas such refineries controlled 4 percent of our light product imports in 1975, by 1984 this had risen to 36 percent. When all products are included, the figure is close to 60 percent. Government's ability to discount the price of state-owned crude or crude obtained through countertrade deals (e.g., exchange of crude for one or more other commodities) to government-owned refineries can lead to rapid market aberrations.

Similarly, the growing import penetration of traders, marketers and blenders who have increased their share of the U.S. market by over 300 percent since 1978 to 50 percent in 1984 adds new actors who may be far more willing to market "discounted" products than will domestic refiners with large investments in refining and distribution facilities that have to be amortized. The impact that countertrade deals and other "non-market" arrangements are having on the market merits serious attention.

Over the next several years, there will be profound changes in the oil products market. The closing of Caribbean refineries such as Shell's 320 mbd refinery in Curacao, Netherlands Antilles have, in the last several months, sparked discussions between the Antilles, the Hague and Venezuela about investments to upgrade the refinery to produce light products for export. Similar discussions are underway in Panama, Guatemala and the Bahamas. These are examples of governments taking over uneconomic and excess refining capacity, abandoned by private companies, primarily to achieve social goals such as maintaining employment. Oil-producing governments like Venezuela see this as an opportunity to increase crude sales or maintain crude sales that would otherwise be cancelled. While some analysts have expressed concern that Venezuela and Mexico may further increase the volume of petroleum products in the market, this appears unlikely because new refinery additions will be needed to meet rising internal needs. Nonetheless, a collapse in the price of crude oil could lead to such a reduction of economic activity in those nations that new "surplus products" could come on the market, posing intense short-term price competition for U.S. refiners. The Caribbean could also see a significant increase in ethanol production aimed at the U.S. gasoline additive market in response to lead phasedown regulations.

In March 1985, EPA accelerated the timetable for reducing metallic lead in gasoline by 90 percent by January 1986. Superfund legislation placing additional costs on U.S. refiners is placing U.S. domestic refiners at a cost disadvantage vis-a-vis their foreign competitors, who are not subject to similar costs. If this artificially created cost advantage for foreign refiners is not equalized, the U.S. domestic refinery industry will lose U.S. market share. While the European Economic Community has announced its intention to embark on lead phasedown, the slow implementation of the program is allowing European refiners to add lead to lower-octane gasoline for domestic consumption and export large volumes of high-octane unleaded gasoline, primarily to the United States. While this situation will disappear over the next two years, until that time some additional U.S. refining capacity is at risk of being displaced.

The need to reduce lead has generated interest in ethanol as one of several octane enhancers to meet the new EPA requirements. While a detailed analysis of ethanol and its competitors is beyond the scope of this analysis,[8] existing loopholes in the U.S. tariff classification system which allow ethanol and gasohol (gasoline and ethanol blends) favorable tariff treatment have led to a surge in the import of these commodities, placing U.S. refiners in a difficult competitive position.

While ethanol imports from outside the CBI are subject to a $.60/gallon tariff, numerous loopholes recommended to be partially closed by the ITC in mid-September 1985 have allowed the tariff to be circumvented. For example, Brazilian ethanol was able to be "reprocessed" in the CBI nations, thus avoiding the tariff. If gasoline and ethanol were blended, the lower gasoline tariff of 1.25¢ per gallon was applied. These loopholes place domestic refiners at a considerable cost advantage, especially those who have already embarked on other solutions to the accelerated lead phasedown standards.

OPEC Product Exports

To date, the debate over rising volumes of imported petroleum products has centered on the Middle East, despite the fact that Middle East export refineries currently export a small volume of products to the United States. This will change as OPEC increases its export capability for light products. PIRINC assumes OPEC's light product export capability will grow from 1,022 mbd in 1984 to 1,845 mbd in 1990,[9] with export surpluses higher in 1987-88 because of constraints on OPEC demand before 1990. In reality, the situation may be more complex.

In 1985, Saudi Arabia has become a significant exporter of unleaded gasoline to the United States. Because OPEC internal product demand has slowed in response to reduced economic activity brought about by falling crude oil prices, OPEC's exportable surplus of light products could be as high as 2

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mmbd in 1988. Approximately 1.4 - 1.6 mmbd of this export capability will be in the Middle East and North Africa.[10]

Table 2 shows OPEC refining capacity in 1984 and planned expansions:[11]

TABLE 2

OPEC MEMBER REFINING CAPACITY
(Millions of Barrels per Day)

	1984	1985	1990	Net Additions 1984-1990
Iran	670	720	1,020	350
Iraq	366	366	440	74
Kuwait	614	614	670	56
Qatar	60	60	60	0
Saudi Arabia	940	1,170	1,745	805
U.A.E.	135	180	350	215
Subtotal:	2,785	3,110	4,285	1,500
North Africa				
Algeria	471	471	471	0
Libya	130	350	350	220
Other Africa				
Nigeria	247	247	372	125
Gabon	44	44	44	0
Others				
Ecuador	95	95	105	10
Venezuela	1,225	1,225	1,225	0
Indonesia	500	900	900	400
GRAND TOTAL	5,497	6,442	7,752	2,255

As dramatic as these figures are, they mask the real level of U.S. dependence on OAPEC and OPEC source crude oil and petroleum product imports that will occur over the next decade. The existence of third party processing deals, countertrade deals and netback sales presage growing challenges to the U.S. domestic refining industry. Unless these "arrangements" are clearly monitored to ensure that they do not pose unfair competition to U.S. domestic refiners, further U.S. refinery closings will occur which will threaten U.S. security.

It is difficult to assess the nature, scope and timing of the threats posed by the new export refineries because of construction delays, conflicting data and policy changes. For example,, whereas the recent PIRINC report places OPEC refinery capacity in 1984 at 5.5 mmbd, a July 1985 assessment by Gulf Oil places it at 7 mmbd. Gulf estimates that this will grow to 9 mmbd by 1987 and that product exports will grow from 3 mmbd in 1984 to 4 mmbd in 1987.[12]

The complexity of techniques used by OPEC members to maintain production levels is demonstrated in Table 3.[13] Please note that Table 3 does not address netback deals with refineries in Europe or elsewhere, or other trading relationships which are most threatening to U.S. refiners without access to such arrangements.

TABLE 3

METHODS USED TO MAINTAIN CRUDE OIL AND REFINED PRODUCT PRODUCTION

Saudi Arabia - Boeing Aircraft barter, Norbec storage, Latsis processing deal, discounted product sales

Iran - Barter with Japanese, crude discounts

Iraq - French arms barter, time swap with Saudis/Kuwaitis, crude processing with ELF, CFP, crude barter for new pipelines

Kuwait - Subsidized product sales

Qatar - Discounted crude sales

UAE - Upper Zakum "Test Oil," extended credit, spot sales, condensates

Venezuela - Expansion of condensate/NGL sales, processing agreement

Ecuador - Spot crude sales

Indonesia - Countertrade products for crude, use satellite trading companies, increased condensate sales, Sumatra light renamed medium

Gabon - Producer allowance

Algeria - Extensive product sales

Libya - Barter for arms and heavy industry development

Nigeria - Extensive new countertrade agreements with Brazil, France, Italy and Austria

From Table 3, it is apparent that large volumes of crude oil are being transferred to non-OPEC refiners for processing. In some cases, products are also being sold directly on indirectly at subsidized prices. It is also true that the complexity of these arrangements may well mask the level of U.S. dependence on insecure sources of both petroleum products and crude oil.

In this regard, the recent decision by Saudi Arabia to abandon its long-standing support of the OPEC pricing system and to engage in netback sales with Exxon, Texaco, Mobil and Royal Dutch Shell may presage the beginning of a major transformation of the international petroleum market. While the complete details of the Saudi netback deals remain obscure, the pricing of Saudi crude based on refined product prices in European markets will change the balance of competition in world product markets.

From recent statements by Saudi and Kuwaiti officials, there is strong evidence that the Saudi decision to embark on "netback" and barter deals (e.g. trading crude for aircraft from the U.K.) are part of a concerted effort to force the price of crude down and thus regain control of the world oil market. The Saudi policy is clearly supported by Kuwait.

Both nations believe the price of oil is too high and that by forcing the price downwards in the short run, their long-term markets will be protected. By taking such action today, the Saudis hope to stop the rapid decline in world oil demand that has occurred since 1980 and perhaps to stimulate increased demand faster than would unencumbered market forces. Second, the Saudis are deeply worried about the prospects of a world recession and believe a reduction in oil prices can retard this. Third, many Saudis believe that lower oil prices will slow inter-fuel substitution, conservation, and the development of high-cost oil production in the North Sea, Alaska and the Third World. Fourth, Saudi Arabia is determined to regain control of OPEC and the world oil market. In such a situation, Saudi Arabia, Kuwait, and some other members of OPEC may well be willing to undercut OPEC's official crude oil prices for a short period of time by selling subsidized petroleum products and/or crude oil to refiners and marketers. What better way for Saudi Arabia and Kuwait to discipline the more recalcitrant members of OPEC than by raising production levels of crude and subsidized petroleum products? To the extent that this an be done by manipulating product prices, the Saudis could, to some degree, mask the real intent of their actions to the other members of OPEC.

Even before the Saudis abandoned the official OPEC pricing system, U.S. officials and refiners became concerned that unless Japan and the EEC reduce their tariff and non-tariff barriers and admit large volumes of OPEC petroleum products, the products will flow to the U.S., leading to further refinery shutdowns. However, in the changed market situation unleashed by the Saudis, it will be extremely difficult for domestic refiners without access to netback deals to compete in the marketplace. Even if all future Saudi sales are based on "netback" terms, there are still concerns that direct Saudi-subsidized product sales based on low-cost crude oil or preferential terms for the former Aramco partners could place other refiners at a competitive price disadvantage.

What does seem clear is the validity of Philip K. Verleger's observation that these new Saudi netback deals will lead to a major change in the "relationships between world crude oil markets."[14] Saudi netback deals will erode the differential between New York and northwest European crude and product markets. Consequently, to preserve the historic U.S. Gulf Coast product price differential, U.S. crude producers will have to cut prices which, as the Saudis force the price down, could lead to sagging production revenues, closings of high-cost fields and rising crude oil and petroleum imports from the Middle East.

Without U.S. Government knowledge of the terms of some of these countertrade, processing and netback deals, the price of the crude feedstock and/or product is unknown. In such a situation, the recipients of the crude (often government-owned refineries) can in turn sell the refined products to an independent marketer at prices only known to the buyer and the seller. These varied activities make it nearly impossible for the Dutch auditing firm hired by OPEC to monitor the organization's marketing activities. It is against this background that the subject of OPEC oil product exports merits further examination.

Moreover, whereas PIRINC places the transfer of the former Exxon U.K. Milford Haven refinery to Ajman in the United Arab Emirates in the class of "speculative capacity additions" by 1990, the August 19, 1985 issue of the Petroleum Intelligence Weekly says that at least 100 mbd of the 170 mbd capacity will start up in early 1988 with a yield of 64 percent light products.[15] Likewise, in recent weeks, Saudi Arabia has announced that the start up of its Rabigh refinery will be delayed by one year to late 1986.[16] The refinery will have a design capacity to allow an annual production of 2.6 million tons of naphtha, 1.4 million tons of kerosene, 3.4 million tons of gas/diesel oil and 7.1 million tons of fuel oil. The storage capacity will consist of 33 tanks for 20 million barrels of products and 21 tanks for 22

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million barrels of crude, allowing the refinery to operate for 60 days without fresh crude stocks.[17] This configuration will allow the Saudis tremendous market flexibility. It should be noted that the 250 mbd refinery at Yanbu, the 250 mbd refinery at Jubail and the 325 mbd refinery at Rabigh are all built for export, and that the Yanbu and Rabigh refineries will produce products to meet U.S. environmental specifications.[18]

On balance, the volume of light products which the Saudis will be able to place on the market is difficult to determine owing to: (1) uncertainties about internal Saudi demand in response to ever-changing revenue streams; (2) the ability of these new export refineries to refine both Arab light and Arab heavy crude oils with different light product; (3) uncertainties about the rate at which they will operate; and 4) the impact of recent changes in Saudi oil policy on the market. It appears that light product export volumes from these refineries alone will probably vary between 375-450 mbd.[19]

Since the three foreign joint-venture partners -- Mobil (Yanbu), Shell (Jubail) and the Greek firm Petrola (Rabigh) -- are responsible for marketing 50 percent of the output and Petromin the rest, any price subsidization of these products through discounted crude feedstocks, low refinery fuel costs, tax holidays or other means will have a major impact on U.S. domestic refiners, especially independents.

As well as the planned additions in Saudi Arabia, the advent of a new 27,000 b/d hydrocracker at Adnoc's Ruwais refinery (UAE) will enhance market flexibility and add an additional export capability for gasoline, distillates and naphthas. This addition is not reflected in PIRINC's figures in Table 3.

Domestic U.S. refiners are especially worried that OPEC governments with access to their own crude are selling it to their government-owned refineries, or to other overseas refineries, at a price below that charged to U.S. domestic refiners either directly or through crude oil trading companies. Since the market price of OPEC crude is far above its cost of production, especially in the Persian Gulf where production costs average less than $1.00/bbl, OPEC national oil companies can either subsidize the cost of the crude to their own refiners or operate at a loss by allowing their highly profitable production operations to offset refinery losses. The International Trade Commission (ITC) recently investigated this issue and discovered that many OPEC nations sell oil to their refineries at prices ranging between \$3-\$12/bbl.[20]

While these actions alone would pose a significant economic threat to U.S. domestic refiners, the situation is further complicated by the fact that several OPEC nations have a wide variety of processing deals with refiners, marketers, etc., in the major oil importing nations which may be the beneficiaries of subsidized crude oil and petroleum products. Under one type of processing deal, the crude oil-producing nation pays a product refiner an agreed to "processing fee" for converting crude to oil products and marketing them, in lieu of selling crude oil to a refiner at current market prices. The situation is further complicated by the fact that the refiners who participate in these deals are often government-owned refiners in Western Europe who agree to such deals for political reasons (employment concerns). Because these government refiners can be indifferent to margin economics, a situation not possible for independent refiners, they can agree to these deals to shore up government revenues.

The existence of processing deals between some OPEC nations and key importing countries or companies raises serious national security issues. While the motivations for such deals are complex and can involve royal princes who need to sell their "princely crude" in a glutted oil market, the chief motivation of OPEC governments involved in such transactions seems to be to enhance revenue. Through countertrade deals and other mechanisms, producers are able to discount from OSP or government-established pricing benchmarks without appearing to undercut them. Whatever the motivation, low-priced gasoline imports reduce gasoline margins in the U.S. market, placing some already-vulnerable U.S. refiners at financial risk.

The ability of OPEC producers to undercut U.S. and other refiners without access to preferential deals also arises through joint venture partnerships with Western companies, by the direct entry of some OPEC crude oil producers into downstream markets and through countertrade deals with the East Bloc, Third World nations, OECD governments, and private companies.

Joint processing and marketing deals such as those of Royal Dutch, Petrola, and Mobil with Saudi Arabia, Libya with Italy, Greece, Turkey and Rumania, and Kuwait with ELF (Belgium) demonstrate how the impact of OPEC product exports may be far greater than generally perceived. In the case of Shell, Mobil and Petrola, since each is obligated to market 50 percent of their refinery's output, it seems clear that they will close existing refineries (even fairly sophisticated refineries such as Mobil's facility at Wilhelmshaven) to make way for Saudi products. In the case of Wilhelmshaven, a refinery targeted for NATO use, one must query whether NATO's security plans were a factor in Mobil's decision. Similarly, to the extent that joint-venture private partners receive crude at subsidized prices, other refiners cannot compete.

More than any other major oil-producing country, Kuwait has pursued a strategy to integrate downstream product sales with crude production. In 1983, the Kuwait Petroleum Company bought Gulf Oil's refining and marketing facilities in Belgium, the Netherlands, Luxembourg, Sweden, Denmark and Italy. The takeover included 3,000 retail service stations, two refineries in Denmark and the Netherlands, a modern research laboratory in Rotterdam, three blending plants for lube oils, and part of the supply of jet fuel at the airports of Amsterdam, Brussels, Copenhagen, Luxembourg, Milan, Rome and Stockholm. Refinery operations have subsequently been upgraded.[21]

In the course of this acquisition, no serious national security questions were raised about the purchase by a foreign government of key outlets for transportation fuels in Europe. Likewise, to the extent that products from Kuwaiti-owned refineries are marketed in or outside Europe, they are not regarded as Middle Eastern or OPEC-source products. Kuwait has also tried to buy retail and refining interests in the United States and has expressed interest in penetrating the U.K. gasoline market.[22]

PIRINC notes that Kuwait's refinery capacity is slated to grow by only 56 mbd between 1985-90 . However, in late August, Kuwait announced that by late 1986 its capacity would reach 650 mbd and that, following modernization, all three of its major refineries would produce high-grade petroleum products for export. Kuwait's refineries are already among the most sophisticated in the world, with a potential export capability of 470-490 mbd today. These refineries have been the target of at least one major and four minor terrorist attacks. Given the recent assassination attempt on the Emir of Kuwait, one must query the prudence of allowing U.S. refining capacity to be placed at risk by becoming more dependent on oil product supplies from politically-volatile nations.

Kuwait's acquisition of large gasoline retail outlets in Belgium from ELF, throughout Europe from Gulf, and recent attempts to buy outlets in the U.S. Gulf and East Coast markets, raise questions as to what extent Kuwait has made or will make special crude oil processing deals with ailing refineries in other countries. Even if no such commercial actions are taken, the question arises of how these OPEC-owned retail outlets would fare in the event of a cutoff of Middle East oil. The closing of gasoline stations in the United States and Western Europe under intense price competition has caused analyst Dan Lundberg and the U.S. Department of Energy to express concern, over both the loss of significant storage capacity and its potential impact in exacerbating public panic in a supply crisis. This will be especially true if OPEC-owned retail outlets no longer have access to their gasoline supplies during a crisis.

Still other arrangements that mask the level of OPEC oil refined into products are crude oil processing deals on a netback basis between Libya and Italy,[23] Greece, Turkey and Rumania, where real economics can be hidden by the undervaluation of crude, and various subsidies to government refineries in the processing countries. Libyan crude is embargoed by the United States under Section 232 of the Trade Expansion Act of 1962, but refineries in nations supplied by Libya export gasoline and naptha to the United States. In the case of Rumania, subsidies to Rumanian refiners allow gasoline sales to be made into the United states, earning valuable foreign exchange.

Another mask for OPEC exports is the near-doubling in the last two years of reexports of OPEC crude by the Soviet Union to Western markets. In 1984, these reexports rose nine times faster than net Soviet shipments of oil and refined products to the West, producing $3 billion or almost one-fifth of Soviet oil earnings.[24] OPEC crude oil can be acquired through barter deals (Libya), as payment for military assistance (Angola) or in other countertrade deals. In the case of Saudi Arabia, "war relief" crude produced for Iraq's account at unknown prices is delivered to Moscow to pay for Soviet arms sales

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to Iraq. The fact that Moscow can reexport this crude and/or refined product at a profit suggests that it was obtained at prices not available to U.S. and other refiners. To the extent that this crude is refined in Europe and then placed into Atlantic Basin markets, U.S. refiners can find themselves at a competitive price disadvantage. While the volume of reexported Soviet crude oil imports from OPEC and non-OPEC sources is only about 275-300 mbd[25], such exports at the margin can devastate product netback values, placing severe strains on U.S. refineries. U.S. refiners already under financial stress are further injured by marginal import supplies at depressed prices which can depress U.S. market prices.

Canada

Even in the case of North American suppliers of petroleum products to the United States, the source of product feedstocks may be masked. For example, in contrast to some recent assessments[26] that see Canadian light product exports to the United States remaining miniscule (51 mbd in 1984), this may not continue to be the case, especially in the northeastern United States. In the wake of Canadian oil price decontrol, eastern Canadian refineries will become a major competitive "focal point" where Canadian crude will vie for markets with offshore and U.S. crudes. While oil product swaps have occurred along the border for many years, oil price controls and logistic bottlenecks have made it less expensive to import crude from the Middle East and elsewhere for processing in Eastern Canadian refineries than to bring Western Canadian crude to Eastern Canada. Consequently, many Canadian product exports to the U.S. market are actually refined from OPEC crude oil. The inherent dangers in this relationship were demonstrated in 1973-1974 when Canada, in response to OAPEC crude oil curtailments to Eastern Canada, curtailed both product and crude oil exports to the U.S. While product export curtailments were volumetrically small, sizeable market dislocations occurred. In the case of crude oil, the vulnerability of Eastern Canada to OAPEC led to Canada's saving its Western crude production to meet domestic demand. In the ensuing market melee, U.S. refiners along the U.S. northern tier lost nearly 1 mmbd of crude feedstocks, posing serious financial problems.

With Canadian oil decontrol now in effect, potential problems have not been alleviated. Oil price decontrol has spurred Canadian production and led to a surplus situation relative to Canada's internal needs. In 1986, this could amount to as much as 300 mbd of surplus heavy crude oil and 300 mbd of surplus light crude. In 1984, total Canadian product exports were 150 mbd, 50 percent higher than product imports.[27] In the first six months of 1985, Canada exported 58 mbd of gasoline and blendstocks alone to the U.S., much of it to Northeastern U.S. terminals.

The move by Saudi Arabia to adopt netback pricing will lead to increased competition in Eastern Canada between Canadian and Middle East crude. To the extent that Canadian crudes are backed out from eastern markets, they will seek alternative market outlets either as crude or product exports to the U.S.

At the same time, some ailing refineries in Eastern Canada (though primarily residual producers) might be wooed with discounted crude sales by Kuwaiti or other producers anxious to find oil outlets or to take over a refinery contiguous to the U.S. East Coast market. In such a scenario, the prospect of larger volumes of Canadian product exports derived in part from OPEC crude sources is a distinct possibility.

U.S. Government regulations concerning the export of U.S. crude oil have been changed by Presidential Proclamation as announced in 50 Federal Register 25189 of June 14, 1985, to permit crude oil from the lower 48 states to be imported directly into Canada. The effect of this proclamation needs to be scrutinized by U.S. Government planners to ensure that it does not add to the problems of U.S. domestic refiners.

Asia-Pacific

While PIRINC has conducted a good assessment of the role that increased demand in the Asian/Pacific region can play in alleviating the impact of OPEC's light product exports (525-725 mbd of 1.84 mmbd in 1990)[28] on the OECD economies, the impact on Singapore's refining capacity raises serious concerns about the degree to which "special processing" deals between ailing Singapore refineries and some OPEC members could be effected to allow more hidden OPEC-sourced products to enter the market.

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Asian petroleum product demand in 1990 is estimated to be 4.6 mmbd. Asian refinery capacity remains uncertain, owing to questions concerning China's refinery construction plans and the possibility that some Singaporean refineries will close under financial pressure from the new OPEC export refineries. There is clearly a possibility that some Asian refiners will consummate below-market deals, either for political or economic reasons, to remain in operation. While it is difficult to project their impact, this could lead over time to small increases in light product shipments to the U.S. West Coast or Hawaii. Kuwait has expressed interest in obtaining a financial interest in both Malaysian and Singaporean refineries.

Tariff and Non-tariff Barriers in Europe, Japan and the United States

Europe

The refining situation in Western Europe poses vexing problems for European governments. Primary distillation capacity in the EEC has been reduced by 33 percent from its peak in 1977 of 845 million tons/year (16.9 mmbd) to 570 million tons (11.4 mmbd) in mid-1985. Capacity in terms of operable capacity in mid-1985 stands at 545 million tons (10.9 mmbd) versus current demand of 450 million tons/year (9 mmbd).

EEC statistics are at sharp variance with OECD Europe statistics owing to the differing memberships. OECD refining capacity has dropped from a high of 20.8 mmbd in 1978 to 16.1 mmbd in 1985. With further announced refinery closings of over 1 mmbd, OECD refining capacity will be around 14.5-15 mmbd by 1990.[29] With oil product demand expected to grow only slightly by 1990 from current levels of 11.5 mmbd, barring a collapse in the dollar or in oil prices, OECD Europe will still have a significant surplus capacity of 3 - 3-1/2 mmbd by 1990. Assuming that a portion of the new OPEC product surplus goes to Europe, OECD Europe's excess supply/demand balance could grow to 3.4-4 mmbd.[30]

EEC policies towards oil product imports may be at sharp variance with those of non-EEC members, such as Sweden, which has announced that it will protect its refineries on national security grounds. This at least suggests that the bulk of European product imports might go to the EEC nations and not to the rest of OECD Europe, further demonstrating the need for the OECD, in concert with the EEC, to open up its markets to the new OPEC export refineries. Otherwise the bulk of those product exports will fall on some of our NATO allies in the EEC. Their failure to do so will ensure that U.S. refiners, already under assault, will receive the full brunt of price competition from these new facilities.

The Community predicts that 1990 oil product consumption will be nearly equal to 1983 consumption levels, (550 million tons/or 11 mmbd) but this view is not shared by the private sector, which expects oil demand to continue to lose ground to lower-priced fuels like natural gas and electricity. It should be noted, however, that these numbers are based on a $29/bbl price for oil. If oil prices collapse, or the dollar falls precipitously, oil demand could rise. In addition,, the problem is further complicated by the entry of Spain and Portugal into the Community, which adds to excess Community distillation and conversion capacity.[31]

According to a recent assessment of the Community,[32] the new export refiners from the Middle East and North Africa will increase total light oil product exports by 1 mmbd between 1984-1990 at an 85 percent utilization rate. The distribution of these products among the major consuming markets of Europe, Japan and the United States will depend on the selling policies adopted by the producers, as well as the "openness" of the three major markets. Assessments by both the Community and others assume that the less-developed countries will not absorb these products; however, this assessment has not been subjected to rigorous examination and could prove incorrect if the price of crude plummets.

Under Community trade policy, no quantitative restrictions are placed on imported petroleum products. Customs duties are not levied on products imported for further processing such as sub-octane gasoline or as feedstocks for the manufacture of petrochemicals (currently under EEC review). However, petroleum product imports for consumption can be assessed duties. These so-called "prevailing duties" of the EEC are lower than the reductions agreed to by some member countries of the EEC under GATT; 6 percent for light and medium oils and 3.5 percent for heavy oils such as gasoils and fuel oils.

imports from the USSR and the United States are dutiable.[33] Each member state can impose higher tariffs or duties on imports from countries not party to EEC agreements. Because of preferential agreements with the European Free Trade Association (EFTA), Africa, Caribbean and Pacific (ACP) and the Mediterranean Basin nations, imports of petroleum products from these nations are exempt from duty.

The Community also extends Generalized System of Preferences (GSP) status to petroleum product imports. Saudi Arabia, Kuwait and Libya are covered under the GSP by a unilateral concession of the Community. Under this provision, imports of products are admitted free, subject to a ceiling set on an annual basis for each type of product and for each exporting nation. As soon as exports reach the ceiling, duties can be imposed at the request of a member state or the Commission. However, since 1979, despite exports above the ceilings, duties have not been imposed. Such ceilings are now being considered on petrochemicals. While the EEC to date has expressed interest in effecting a tripartite agreement with Japan and the U.S. regarding a division of the products from the new export refineries, the failure to obtain an agreement could lead to Europe enforcing tariff schedules or GSP ceilings that could divert large volumes of these products to the U.S. Finally, individual nations can impose ceilings and duties on products if their national security is threatened.

Japan

In contrast to Western Europe, Japan has strict regulations on product imports which, in practice, limit imports to fuel oil and naphtha. Gasoline imports are not allowed, since high prices for gasoline in Japan subsidize kerosene for home heating fuel. The Japanese government also places quotas on both fuel oil and naphtha. While customs duties on most products are quite similar to those in the EEC, this is not the case for fuel oil, on which a duty is levied progressively depending on volume. GSP benefits, while granted to the Gulf nations for many products, do not extend to petroleum products. Although Japan has, over the last several years, resisted any changes in liberalizing its gasoline import policy, in recent weeks it has announced reforms in its oil product import policy. In September 1985, Japan's Ministry of International Trade and Industry (MITI) recommended that imports of gasoline, kerosene and gasoil be allowed. While the recommendations gave no details as to when the policy would go into effect or what regulations would govern imports, the change in policy is an important first step in alleviating pressure on U.S. refiners.

Of some concern, however, was MITI's statement that companies desiring to import products will be required to ensure a secure supply to consumers, despite market fluctuations, by being able to offer a flexible choice or combination of domestically-refined and imported products. It was also made clear that to qualify as an importer, only marketers with refiner affiliations could engage in oil product trading. It was also stated that the volume of oil product imports, especially gasoline, would remain limited.[34]

Simultaneously, MITI announced that it would recommend the scrapping of 700 mbd - 1 mmbd of refinery capacity over three years beginning in 1986. Currently, Japan has about 1.5 mmbd of surplus capacity.[35]

The United States

In contrast to the EEC and Japan, the United States has no quantitative restrictions on the importation of petroleum products. The U.S. tariff system levies tariffs at far lower levels than those prevailing in the Community or Japan. The level of these tariffs has remained static for years and currently ranges from 5.25 cents/bbl for heavy crude oil to 52.5 cents/bbl for motor gasoline.[36] Petroleum products are excluded under the American GSP, although none of the Gulf countries benefit from this legislation. Furthermore, U.S. tariff laws are subject to classification loopholes which have led to a large influx of petroleum products, especially blends of low-octane fuels, gasohol and other products that pose direct competition to U.S. gasoline producers. To the extent that low U.S. tariffs or loopholes encourage such imports at prices that cannot be matched by U.S. refiners, more refineries will close, increasing the national security risk.

Summary

Between 1985-1990, the availability of light products in the U.S. market will be influenced by a variety of events, some of which may offset the effects of others. These are: (1) the price of crude oil, (2) higher levels of light product exports from Canada, (3) the rate of decline of the U.S. dollar and the impact that this will have on petroleum demand and on OPEC surpluses, and (4) the availability of additional OPEC product owing to processing deals in some importing countries and the possibility of lower economic growth leading to fall-offs in internal demand, placing more product into export markets.

Between 1985 and 1990, U.S. and world crude demand and especially demand for OPEC crude will begin to rebound. Although there will be a time-lag, it appears that if crude prices fall in the short run, crude demand will grow, especially in the Third World. This assumes that overall, the world economy will benefit from a resurgence of economic activity, despite sizeable dislocations likely to be caused by falling oil prices. However, in the short run before demand increases, falling oil prices would probably lead to an erosion of economic activity in the OPEC countries, placing additional volumes of oil products on the world market.

Likewise, a collapse of the U.S. dollar occurring in concert with or independently of these potentialities could lead to an erosion of OPEC holdings in non-dollar financial instruments as OPEC draws down its assets to meet current expenditures. This would place additional strains on economic activity in the OPEC countries. Because a falling dollar could lead to increases in petroleum demand in Western Europe and elsewhere as oil became cheaper, OPEC might get some respite. However, in the interim, due to growing financial pressures and a fall-off in economic activity at home, OPEC product export surpluses would exert downward price pressure on world product prices.

The potential volume of enhanced direct OAPEC product sales (385-850 mbd, up from 170 mbd) in 1984, delineated by PIRINC,[37] the Pace Company, Verleger, the East-West Center, and Purvin & Gertz, raises serious financial concerns for U.S. refiners and security concerns for the U.S. Government.

The potential for further netback processing deals, countertrade agreements, government-to-government deals, sales between OPEC countries and their own captive downstream markets, and the need in the Soviet Bloc for hard currency to finance vital Western imports, clearly indicate that the nature and scope of the "oil product debate" may have far larger strategic implications than those addressed to date. If these other economic and institutional arrangements create levels of dependence that mask the real source of crude oil, further refining capacity will be placed at risk unless the U.S. Government takes concrete actions to alleviate the situation. Although it is difficult to quantify the amount of refining capacity at risk as a result of these "other arrangements" owing to the paucity and confidentiality of data, this matter demands scrutiny by the Congress and the Administration.

The fact that this enhanced dependence on OPEC's oil product exports is occurring in concert with projected increased dependence on Middle Eastern OPEC crude in the 1990s has not received any attention in the public policy debate on the national security threat posed by rising volumes of oil product imports. If firm action is not taken, U.S. crude and product import dependence by 1995 could be in excess of 50 percent of total petroleum demand, a level in excess of that found by Secretaries Simon and Blumenthal, in 1975 and 1979 respectively, to be dangerous to U.S. national security.

The threat posed by additional refinery closings should not be underestimated. Even with today's sophisticated refineries, it takes an average of 2.1 barrels of crude oil to manufacture one barrel of gasoline. This means that a direct influx of cheap light products, combined with other indirect product flows arising from the factors discussed above, could place an additional 1.5-2.5 mmbd of U.S. refinery capacity at risk by 1990.

If Saudi Arabia moves, as appears likely, to implement the decision first adopted by the Saudi Arabian Supreme Petroleum Council in June 1985 to discipline OPEC and raise crude oil production, the world oil market will be transformed as the melee unfolds. In such a scenario, U.S. domestic and foreign producers of high-cost oil will dump inventories on the market in large volumes to avoid large inventory losses. As the price of crude falls, relatively high-cost oil production in the United States will be shut-in, leading to a rise in "cheap" imports. In this event, product and crude oil prices (though not necessarily refining margins) will fall. While some well-positioned refiners may be able to remain profitable if they maintain access to crude, discounted oil products will flood the market as refiners both inside and outside OPEC strive to maintain operational capacities at marginal cost as opposed to average cost. In such a situation, access to preferentially-priced crude or netback processing deals could be the margin between profitability and bankruptcy.

In such a scenario, as U.S. refiners and domestic crude oil prices come under the financial onslaught of cheap crude oil and product imports, additional refinery shutdowns will occur. This will leave the U.S. more dependent on crude oil and product imports from insecure sources.

Structural changes in the global market for refined products presage major threats to U.S. and allied security. The commonality of interests among some producing and consuming governments, and hard-pressed refineries may lead to "specialized" trading arrangements not available to other refiners. Ironically, in some of these deals, refiners in friendly NATO and EEC nations may, for political, economic, strategic or commercial reasons, adopt special arrangements that adversely affect U.S. domestic refiners. European and Japanese trade barriers, if not modified or matched by the United States, may exacerbate the flow of petroleum products into the United States. However, the removal of these tariff and non-tariff barriers alone will not address the problem.[38]

PART 2: U.S. Refinery Capacity and National Security

If this growing dependence in non-crisis times leads to a further displacement of the U.S. refining capacity, the ability of the U.S. refining industry to meet DOD and NATO requirements during a full-scale crisis mobilization will be in serious jeopardy. Although generalities as to the precise nature of the market shortfalls involved are both difficult to measure and dangerous to predict in the absence of concrete crisis scenarios, the disparity in the mix of products provided by refiners to civilian and military consumers could cause major supply problems if not given adequate attention.[39]

TABLE 4

U.S. CIVIL AND MILITARY OIL DEMAND MIX IN 1984 IN PERCENT

	Civil	Military
Gasoline (motor and aviation)	43%	3%
Jet fuel	7%	66%
Diesel	18%	17%
Residual fuel oil	9%	13%
Other	23%	1%
TOTAL	100%	100%

Table 4 demonstrates the absolute vulnerability of the military sector to disruptions of light petroleum products. The figures also exhibit the degree to which the military's safety and mission requirements mandate the need for fuels with unique specifications that are not the normal output of many commercial refiners. Specialized military fuels cannot be co-mingled with standard commercial fuels while in storage. Likewise, military fuels within NATO are not always interchangeable in different equipment produced by NATO members.[40] Finally, the move towards heavier crude oil in world trade has led to increased refinery upgrading and hydrocracking, which can lead to problems of fuel stability and aircraft performance for planes designed to burn straight-run distillation fuels.[41]

The military's need for long-term contracts to ensure security of supply, combined with the unique technical requirements described above, have led independent refiners to supply 50 percent of military fuel needs, while accounting for only 26 percent of domestic refining capacity. In assessing the impact of what constitutes adequate refining capacity both in the United States and European NATO, the impact of light product imports upon the financial stability of refiners vital to U.S. and allied security has not been adequately addressed. In this context, it should be noted that an increase in demand for transportation fuels of 3-4 times means an increase in demand for high specification fuels, which may place demands on the refining and distribution system far in excess of what the volumetric numbers indicate.[42] With several refineries capable of meeting NATO's needs having recently closed in Europe, some DOD officials have expressed concern how these closures, combined with further refinery closures in the United States, might affect NATO oil-sharing in a crisis.[43]

Operating vs. Operable Refining Capacity

To ensure that adequate domestic refinery capacity for mobility fuels is available to meet national defense contingencies, it is necessary to assess the current level of operating capacity and make a determination of how much idled but "operable" capacity could be restarted quickly in the event of a crisis.

Since 1981, numerous factors have led to a major rationalization of the U.S. refining industry. From a peak of 18.6 mmbd of refining capacity in January 1981, U.S. "operable" refining capacity fell to about 15.6 mmbd in July 1985. The 15.6 mmbd figure, frequently cited in government statistics, includes currently operating capacity plus idle capacity that could supposedly be returned to service within 90 days. The chief problem with the government's statistics is that capacity reported "idled" includes capacity that has been closed for such a long time that there is a serious question as to whether it can ever be operated again. According to recent testimony by Texaco,[44] of the approximately 1.3 mmbd of "operable" refinery capacity that has been closed since January 1, 1983, 700 mbd has been permanently closed while 600 mbd remains potentially operable. However, only 300 mbd could be brought back to service within 30 to 90 days. In this regard, it should be remembered that the 1973 OAPEC oil embargo, which wrought havoc on the world petroleum market, lasted only about 165 days. In the event of a shortage, even bringing back the 300 mbd of capacity would not be assured. In order to restart a 100 mbd refinery, capital expenditures estimated at $250 million would be required. In addition, trained personnel would have to be located to ensure safe operation. With the erosion in refinery margins since

1983 brought on by the increase in oil product imports, it is extremely unlikely that such expenditures would be made.

In the course of this analysis, it became apparent that many government policymakers do not fully understand either why a refiner may choose to carry a refinery on its books as operable but idle -- even after it has been permanently shut down -- or what is involved in restarting an idled refinery. In the first case, environmental legislation such as the Resource Conservation Recovery Act encourages refiners to carry refineries on their books as "operable", since closing a refinery can incur huge environmental costs relating to the disposal of hazardous wastes -- estimated by the Pace Company to be $1000 per barrel of nameplate capacity.

Similarly, plants considered operable can receive favorable tax treatment (depreciation) as opposed to those that are closed down. While tax writeoffs against consolidated profits would seem to encourage permanent closings, marginal refiners already deeply in debt are loathe to further reduce their bottom lines owing to concerns about the impact of such losses on their ability to borrow new funds for operations.

In the latter case, based on independent conversations with 10 oil refiners (5 independents, 5 majors), one derives a consensus that a period of 75 to 200 days is the approximate time needed to start up a 100 mbd refinery idled for more than six months.[45] Likewise, there was near-consensus that operating rates of 85 percent, or higher, could not be achieved for 5-6 weeks after startup.[46] Moreover, in order for operations to be maintained, 50-60 days of crude oil needs to be purchased and on hand at the refinery.[47] Clearly, to the extent that U.S. dependence on imported oil increases, transportation lead-times as well as crude oil availability have to be factored into any equation relating to how fast idled capacity can be brought back on line.

The problem of what constitutes adequate domestic refining capacity is further complicated by the fact that refineries do not run at nameplate capacity or even calendar day capacity (less than nameplate, adjusted to reflect downtime for maintenance and seasonal shifts in product slate) but at levels closer to 85 percent of capacity. Only twice in the last 35 years has the U.S. industry surpassed 90 percent utilization rates for as much as a full year.

Given the inadequacy and conflicting nature of the data on "operating" versus "operable" capacity, it appears on balance that the United States' available refining capacity is around 14.3 mmbd, with an additional 300 mbd possibly available in 30-90 days (raising the total to 14.6 mmbd). Over a period of six months to one year, an additional 300 mbd might be available. During the preparation of this report, the author was told in interviews with petroleum industry members that current operating capacity is between 14 - 14.3 mmbd.

Utilizing the figure of 14.6 mmbd, this means the U.S. has about 12.4 mmbd of operating refining capacity at 85 percent utilization; at 90 percent utilization rates, this would rise to 13.1 mmbd. Of the 10 companies interviewed for this report, no company believed that more than 300 mbd of currently idle capacity could be made available in 45-60 days. The implications of the above figures are vital to U.S. national security.

Over the next decade, U.S. and European imports of petroleum products and crude oil will rise to levels commensurate with those that Secretaries Simon and Blumenthal found threatening to U.S. national security in 1975 and 1979 (see Part 3 of this report). To the extent that the United States also becomes dependent on additional volumes of imported petroleum products from sources that are perceived to be "secure" in Western Europe, Singapore, the Caribbean, etc., but are in reality to some degree dependent on OAPEC crude supplies, the real vulnerability of the United States will be obfuscated.

This dependence will be especially dangerous in the gasoline and naphtha market, given the importance of these products to military mobilization. While a precise determination of the current level of dependence on insecure sources is hard to ascertain, this issue demands a detailed investigation by the U.S. Congress and the Reagan Administration.

Imports of gasoline and naphtha from all countries are shown in Table 5:[48]

CHART 14

TABLE 5

U.S. Gasoline & Naphtha Imports
Cumulative January-June, 1985

(Barrels)

Country Of Origin	Leaded Gasoline	Unleaded Gasoline	Naphtha	Total	MB/D
Venezuela	0	4,927,960	6,859,595	11,787,555	65.1
Netherlands	3,358,194	7,701,036	162,475	11,221,705	62.0
Canada	3,453,930	5,471,125	1,557,863	10,482,918	57.9
Italy	6,585,864	1,995,084	1,090,689	9,671,637	53.4
Romania	274,059	293,296	5,010,320	5,577,675	30.8
Saudi Arabia	542,691	4,842,294	0	5,384,985	29.8
Brazil	1,812,072	2,107,672	280,396	4,200,140	23.2
United Kingdom	494,273	2,679,361	871,784	4,045,418	22.4
Neth. Antilles	1,036,122	1,173,476	1,315,389	3,524,987	19.5
China	2,681,141	234,303	0	2,915,444	16.1
Indonesia	0	0	2,289,734	2,289,734	12.7
West Germany	1,983,294	89,602	0	2,072,896	11.5
Spain	260,221	1,092,221	594,965	1,947,407	10.8
France	175,027	1,412,476	322,494	1,909,997	10.6
Bahamas	0	0	1,572,870	1,572,870	8.7
India	0	0	1,569,028	1,569,028	8.7
Turkey	0	1,059,864	229,404	1,289,268	7.1
Belgium	259,734	417,611	490,802	1,168,147	6.5
Greece	901,232	0	239,852	1,141,084	6.3
Algeria	0	0	918,584	918,584	5.1
Bahrain	262,268	0	586,344	848,612	4.7
U.S.S.R.	427,833	0	283,735	711,568	3.9
Israel	508,187	0	91,476	599,663	3.3
Singapore	0	0	491,185	491,185	2.7
Yugoslavia	323,075	0	0	323,075	1.8
U.A.E.	312,901	0	0	312,901	1.7
Libya	0	0	244,521	244,521	1.4
Peru	0	0	222,929	222,929	1.2
Korea	143,045	0	0	143,045	0.8
Argentina	0	0	105,032	105,032	0.6
Panama	59,843	27,141	0	86,984	0.5
Trinidad	15,036	18,275	0	33,311	0.2
Japan	0	0	13,756	13,756	0.1
Undersized	1,760	10,637	178,415	190,812	1.1
Total	25,871,802	35,553,434	27,593,637	89,018,873	492.2
MB/D	143.0	196.4	152.5	491.9	

(1)Shipments of less than 10,000 barrels each, details not published by Platts.

Source: U.S. Department of Commerce, Import Series IM145X, as published by Platt's Oil Export/Import Report.

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What Constitutes An Adequate Refining Capacity? .

Most analysts agree that ensuring an adequate level of U.S. domestic refining capacity is vital to U.S. national security. The problem is that there is no consensus either as to what constitutes an adequate level of refinery capacity or what criteria should be employed to make that determination. The debate is further clouded by contradictory policy goals that appeal to different constituencies. For instance, the tradeoff between the need for accelerated lead phasedown to solve public health concerns generates attendant financial pressures on some U.S. refiners that may force the closing of more refineries.

Still another dimension of the problem is the changing nature of the international crude oil and refined product markets, which presage rising U.S. and allied crude oil and refined product import dependence on OPEC over the next decade. This rising dependence has led to a debate over whether increased dependence on OPEC refined products is more or less threatening to U.S. national security than increased dependence on OPEC crude oil.

It is the thesis of this report that rising refined product import dependence and the closing down of U.S. refineries will reduce the flexibility of the domestic refining industry to meet civilian and military demands in a variety of crisis scenarios. This is especially true in regard to effective utilization of the U.S. Strategic Petroleum Reserve and the U.S.'s ability to meet its obligations to the International Energy Agency (IEA).

The U.S. Strategic Petroleum Reserve

The major focus of emergency supply planning in the United States has been the development of the Strategic Petroleum Reserve (SPR). Strategic stockpiling has long been part of U.S. defense policy. As early as 1912, President Taft set aside petroleum fields to ensure strategic stocks for the naval fleet. With the passage in 1975 of the Energy Policy and Conservation Act, Congress authorized the creation of a Strategic Petroleum Reserve, establishing for the first time the concept of a "strategic reserve" for the civilian economy. By the end of fiscal 1985, the United States will have spent about $16.7 billion to build the SPR to 489 million barrels. When the reserve is expanded to 750 million barrels sometime in the late 1980s (assuming Congressional appropriation) at a cost of $27 billion, it will have a drawdown capability of 4.5 mmbd. Currently, the maximum drawdown capability is about 2.9 mmbd. Though current distribution capability is 2.3 mmbd, this will rise by January 1987 to a drawdown and distribution capability of 3.3 mmbd. Clearly, U.S. refining capacity must maintain the capability to utilize the SPR at full potential to ensure U.S. national security.

The International Energy Agency

The International Energy Agency (IEA)[49] was established in 1974 to coordinate the consuming nations' energy policies, in response to the oil shocks of 1973-74. The IEA program was designed to effect short-term responses to energy crises through a variety of mechanisms -- an emergency stockpile program, a demand restraint (conservation) plan, an international allocation system, and an information system on the international oil market.

In the IEA system, the emergency reserve commitment can be satisfied by oil stocks, fuel switching capacity, standby oil production and not just by strategic stocks such as the SPR. To date, participating countries have also developed different approaches to their strategic stockpile programs. While some nations such as the United States separate their emergency reserves from commercial inventories, others combine them. Still others use a combination approach with some "strategic reserves" held by the government and some by the private sector. Clearly, given the diverse nature of these strategic reserve programs, it is essential that drawdowns be coordinated to ensure not only the availability of refining capacity but also that markets are not skewed if a drawdown occurs in one region but not in another. Nonetheless, as currently conceived, there is the likelihood that the diversity of programs may work against a finely-tuned, coordinated response by governments leading to the implementation of market allocation mechanisms which could exacerbate the impact of an import disruption. In 1979, such allocation procedures led to major refined product shortages in the United States.

In an emergency, the IEA program calls for a two-step response with a program of demand restraint, followed if necessary by allocation of the IEA member states' oil as needed. The fact that some nations in the IEA have opted for a free market (let price rise) approach to demand restraint, rather than intervention by government, suggests that oil products backed out by government policy in one area might flow to other markets depending on price and other external factors. Once a nation has experienced a shortfall of 7 percent, it must reduce demand by 7 percent before it receives oil supplies from the other members; if the shortfall is 12 percent, a 10 percent demand reduction is implemented.

A 10 percent crude oil demand reduction goal was chosen for two reasons. First, it was believed that greater demand reductions could only be effected by unacceptable price levels or draconian allocation controls. Second, it was perceived that in the absence of severe demand restraints, a political consensus in an oil-supplying country to aid another IEA member could not be gained, since it could lead to shortages in the producing nation. In this regard, it is interesting to note that in the 1983 AST-4 test of the IEA system, the political decision by Washington to let the market, rather than the government, effect a 15 percent demand reduction level sent the price of crude oil to $98 per barrel, apparently justifying demand restraint levels of only 10 percent. Clearly, the disruption caused by $98 per barrel crude oil could not be tolerated.

The impact that an activation of the IEA oil-sharing mechanism could have on U.S. refining capacity is profound. Because the IEA mechanism only relates to crude oil, clearly, the provision of assistance to member states implies that adequate refining capacity is available in the receiving nations to process the crude. The United States could, theoretically, be called upon to process this crude if refining capacity in Europe was not available because of a variety of potential contigencies. Likewise, while the President can use SPR oil to meet our IEA obligations, he can also meet them by diverting oil from domestic production or imports, though various legal restrictions would have to be waived and could cause delays. Even in the case of SPR crude, there could be legal problems because of special bans on exporting Alaskan crude oil, which is mixed with other oils in the SPR.

Furthermore, the adequacy of refining capacity in alleviating a crisis becomes critical owing to the different pattern of refinery demand in these regions, which varies both absolutely and seasonally. If refinery flexibility is not maintained, it will be difficult if not impossible for the IEA governments to help each other in the event of a crisis. Rather, any nation disrupted will be at the mercy of other refiners, especially Middle East refiners, to make up shortfalls in supply of particular refined products.

The efficacy of the IEA oil-sharing mechanism is further complicated by the NATO and EEC oil-sharing plans, both of which are prodicated under EEC obligations on the free interchange of crude oil and the availability of refining capacity to process requisite volumes of petroleum products.

The NATO and EEC Oil Sharing Mechanisms

Unlike the IEA, NATO's oil sharing system is not triggered on a predetermined basis. Rather, in the event of a supply crisis, fuel would be allocated in accordance with NATO'S defense priorities, including essential civilian needs. NATO generally assumes that outside a warfare situation, the IEA would handle the crisis[50] with NATO only monitoring the situation. Two of the chief fallacies of NATO defense planners are the assumptions that some European refinery capacity will be available for NATO's needs, and that U.S., Canadian and Caribbean refinery capacity will be available in all conventional crisis scenarios.

This last assumption is especially dangerous in light of the profound changes that are occurring in the Atlantic Basin product and crude oil markets discussed in detail in Part I. The impact of OPEC product exports on East Coast/Gulf Coast product differentials may well begin to back out Western Hemispheric and Nigerian supplies from the U.S. market, while increasing dependence on the Middle East. While the nature of these market changes is currently embryonic, the erosion of petroleum product export capability, especially from the Caribbean and Canada, could startle NATO defense planners. In such a situation both Western Europe and the United States could find themselves much more dependent on both crude oil and petroleum products from the Middle East, even prior to the outbreak of a major political crisis in the region.

Finally, the utilization of the SPR to meet U.S. obligations under the International Energy Program is also complicated by the European Economic Community's oil-sharing system which includes both crude oil and petroleum products. Because there are few restrictions on the flow of products inside the Community, one can envision a situation where crude oil and petroleum products, at the onset of a crisis, flow into higher-priced unregulated markets such as Germany and not into regulated markets such as France. In such a situation, markets for oil products and/or crude could become distorted, with the attendant impact that the IEA's and EEC's oil-sharing mechanisms could offset each other, leading to spot product shortages and skewed refinery outputs. Although the EEC and the IEA work closely to avoid such problems, officials in both institutions are worried about the impact that such flows could have in exacerbating problems in a crisis.[51]

Given the above considerations, it is apparent that the minimum necessary domestic refining capacity to ensure U.S. national security would be as follows:

TABLE 6

MINIMUM NECESSARY DOMESTIC CRUDE REFINING CAPABILITY
(MMBD)[52]

	1985	1990	1995
1. Oil and NGL Consumption	15.8	16.7	18.00
2. Oil and NGL Production	10.5	9.7	8.5
3. SPR Withdrawal(A)	2.3	3.3 (D)	4.5
4. DOD Mobilization			
Vietnam level conflict	1.3	1.5 est.	1.6 est.
Full U.S. military mobilization	2.5-3	2.7-3.3 est.	3.1-3.6 est.
U.S. and NATO	4.5	5.0 est.	5.9 est.
5. IEA Obligations(B) with SPR drawdawn	0-2.2	1.2	0
6. IEA Obligations(C) No SPR drawdawn	0-4.5	0-4.5	0-4.5
Operating Capacity at Utilization Rate 100% (2+3 above)	12.8	13.1	13.0
Operating Capacity at Utilization Rate 90%	14.2	14.6	14.4
Operating Capacity at Utilization Rate 85%	15.1	15.4	15.3
Current Operating Capacity	14-14.3 mmbd		

(A) The drawdown rate of the SPR will increase in 1986
(B) Assumes SPR is drawn down at fastest rate possible
(C) Assumes closure of the Persian Gulf, no pipeline exports
(D) Assumes drawdown capacity of 3.3 mmbd will remain static in absence of new Congressional appropriation

As shown in Table 6, it is apparent that the decline in U.S. refinery capacity has begun to threaten the national security of the United States and its major allies. If, as projected by several analysts, an additional 1-1.4 mmbd of U.S. refining capacity closes in the next several years, U.S. national security would be gravely jeopardized. If as argued in Parts I and III, over 2 mmbd of U.S. capacity closed, U.S. security would be imperilled.

The difficulty in assessing the degree of threat arises from uncertainty in several areas. There is an unresolved question of how far demand restraint, conservation and inter-fuel substitution could reduce petroleum demand in a crisis. In this regard, residual oil used by the electric power sector now accounts for less than 6 percent of total fuel inputs to the sector. Any savings would have to occur elsewhere in the industrial, residential, commercial and transportation sectors. Likewise, with the least costly conservation already implemented, replacement of equipment will be more costly than in earlier supply crises and not implemented quickly. Conservation and inter-fuel substitution will be important policy options if the United States is going to be able to meet its direct and indirect military and diplomatic commitments while providing fuel to meet essential civilian demand. However, if refining capacity is not available to process mobility and other fuels needed by the military, our security posture would be gravely threatened.

In the military arena, the demand on the U.S. refining sector could vary widely, depending on the nature of the conflict. Whereas the Vietnam War raised energy demand from about 500 mbd to 1.3 mmbd, a conventional war in Europe involving a complete mobilization of NATO forces would require about 4.5 mmbd of crude capacity to meet total NATO force requirements of 3 mmbd of refined products.[53] As noted, this demand would be for highly-specialized fuels that could place severe strains even today on the refinery capability of the NATO nations. Another factor of strain is the impact on fuel supplies if two conflict theaters were to erupt simultaneously (e.g., the Middle East and Central America). In such a situation, the strain on both civilian and military fuel supplies could reduce civilian fuel supplies by 10-15 percent, especially if the Middle East contingency cut off or vastly reduced supplies of crude oil and petroleum products.

Although it is clear that fuel supplies could be drawn away from the civilian economy to meet direct and indirect military needs, it should be remembered that with 25,000 primary DOD contractors and 200,000 subcontractors, fuel allocation procedures could become so burdensome that major dislocations could occur. Moreover, with high technology (semi-conductors, micro processors, etc.) increasingly taking over the defense sector, the lines differentiating the defense sector from the civilian sector are increasingly blurred. While the purely civilian sector could obviously function on less fuel, the non-availability of adequate refining capacity should not be allowed to exacerbate the austerity measures that would be placed on the civilian economy above the 10 percent reduction level.

Because it is unlikely that any foreseeable crisis would completely curtail all crude or product imports into the United States, it seems only prudent for the United States to maintain the capacity to refine domestic crude and NGL production, uninterrupted crude imports, and sufficient crude oil from the SPR to offset interrupted crude and product imports. This will be especially critical to the nation's economy as domestic oil and NGL production fall in the 1990s, making the United States more dependent on crude oil imports. EIA projects that crude oil imports will rise from 4.3 mmbd in 1985 to 6.7 mmbd in 1995. It would seem prudent that we ensure that we maintain the capability to process this oil to avoid having military and diplomatic commitments place too much strain on the civilian economy. This capacity level should keep pace with rising volumes of imported crude. In this regard, it should be noted that if oil product imports in the short run close additional U.S. refinery capacity, then it will be impossible to have the flexibility in a future crisis to process crude that might be available from non-disrupted areas.

Taking all these factors into consideration, it would appear that an adequate domestic refining capability for the nation would require:

(1) The ability to process all domestic oil and NGL production (10.5 mmbd in 1985, 9.7 mmbd in 1990 and 8.5 mmbd in 1995);

(2) The ability to process that proportion of U.S. demand met by imported crude (4.3 mmbd in 1985, 5.2 mmbd in 1990 and 6.7 mmbd in 1995);

(3) The capability to refine sufficient quantities of SPR crude oil to make up for the loss of interrupted crude and product imports. To ensure U.S. and NATO military supplies, the industry should be able to process all the crude oil in the SPR now and in the future (2.3 mmbd in 1985, rising to 3.3 mmbd in 1987 and to 4.5 mmbd in the future, once Congress appropriates the funds);

(4) The ability to meet some increment of defense needs in the event of a major conflict, so that the civilian economy would not have to reduce demand more than 10 percent or about 1.5 mmbd from pre-crisis levels (note that in the AST-4 test in 1983, when supply under free market conditions fell by 15 percent oil prices rose to $98/bbl);

(5) Ensuring U.S. ability to process 4.5 mmbde of crude oil to meet NATO's 3 mmbd product demand in the event of the non-availability of NATO refineries;

(6) Maintaining a small reserve capacity (200-300 mbd) to meet unforeseen events.

Maintaining a domestic refinery capability to effect these goals is vital to U.S. national security. The changing nature of the international energy market presages rising levels of U.S. and allied crude oil and petroleum product import dependence on the Middle East to levels found to be threatening to U.S. national security in both 1975 and 1979. Clearly, in light of these developments and the potential military challenges posed to the United States and its major allies, further reduction in U.S. refining capacity for whatever reason will jeopardize vital U.S. interests. Consequently, the U.S. Government must act to ensure that additional refinery closings do not occur pending a complete review of the situation and the enunciation of a program of action to solve the problem.

A healthy U.S. refining industry is no less essential to U.S. national security than a firm military posture. Two Presidents have declared, under the Carter Doctrine and the Reagan Codicile, that the United States is willing to spend billions of dollars to protect our access to Persian Gulf crude oil. If guarding this crude is a vital interest of the U.S., it is ironic that the current Administration has not yet taken action to safeguard our ability to refine this crude oil or crude oil from alternative sources.

Although "free market" forces are partially responsible for the wrenching rationalization process experienced by the domestic refining industry since

1980, this paper has illustrated the role that nonmarket forces are playing in compounding the problems of U.S. domestic refiners. While there are no easy solutions to these problems, they clearly must not be allowed to threaten U.S. national security.

The U.S. refining industry stands at a major crossroads. With the specter of an additional 1-1.4 mmbd, or more, of refined petroleum products flooding the world market over the next several years, the industry needs the firm support of government at all levels to ensure its financial viability, as well as to protect U.S. and allied security. The industry cannot achieve that objective in competition with an increasing number of government-owned and controlled refineries in oil-producing countries, or from European and other refineries involved in netback and processing deals. The failure of the U.S. Government to formally investigate the nature of the threat posed to the nation and the role that domestic refiners play in maintaining security, and to adopt appropriate responses against threats to the industry, will imperil the security of the Free World.

PART 3: The Crude Oil Situation

Difficulties in effecting serious public debate on the refined product and crude oil issue arise from public and governmental complacency -- a shared perception that the energy crisis is over, that the marketplace is setting energy prices and that the future energy needs of the United States and the rest of the world are secure. Nothing could be further from reality.

It was just a few years ago that energy forecasters predicted that energy supplies would remain tight for the rest of the century. Previous studies done by the petroleum industry predicted that world oil production would reach at least 90 mmbd before peaking between 1985-1995. Actual world production in 1985 will be closer to 57 mmbd.

In the late 1970s and early 1980s almost all long-term assessments by industry, consultants and academics forecasted rising oil prices that would lead to the development of high-cost alternative energy sources, such as shale oil, and coal liquefaction and gasification. The Energy Security Act predicted that U.S. synthetic fuel production would hit 2 mmbd by 1992.

Today, it is apparent that we will be lucky to hit 50 mbd. In almost all of the predicted scenarios, nuclear and coal-fired power plants were to be built on a massive scale. While these two industries have made contributions to reducing dependency on oil, today we have a nuclear power industry under financial and regulatory assault. Coal, despite major improvements in clean burning technology, is under intense scrutiny as a major contributor to the international acid rain problem. Almost all prognoses released during 1979-1982 envisioned that little spare oil-producing capacity would exist anywhere in the world by the mid-to-late 1980s. It was believed that the oil industry would have the incentive to rush out and search for new sources of oil in high-cost areas, such as the frontier regions of the Arctic and the Outer Continental Shelf (OCS), and on other government lands previously off-limits to development.

Although reasonable from the vantage point of 1979 or 1980, these assumptions were basically flawed. What is most surprising is that, given the abysmal record of most all forecasters, their views continue to be solicited. A kind of herd instinct led analysts en masse in the 1970s to predict constrained energy supplies in the mid-1980s. A similar kind of consensus is emerging today: that oil and energy demand will be depressed for the next ten to fifteen years, OPEC will remain under pressure and energy supply security will fade away as a major public policy issue. While some analysts clearly differ on how far prices will slide over the next two years, there are only a few lonely voices such as Henry Schuler, Walter Levy and Melvin Conant now arguing that a major crisis, rather than just a tight market, may loom ahead in the decade of the 1990s.

In the last several months there have been indications that oil prices might once again be heading downwards, posing new strains on OPEC and on much of the international financial community. Too many analysts are focusing on the short-term market and neglecting these implications on the medium-term (the next 5-10 years) market.

Falling oil prices in the short term have been triggered by the following events:

(1) the end of the British coal strike, which has further reduced fuel oil demand by 275-300 mbd;

(2) the still hotly-contested proposal by the Reagan Administration's Office of Management and Budget to end crude oil purchases of 50 mbd for the Strategic Petroleum Reserve beginning in September 1985;

(3) further gains by natural gas, coal and nuclear power at the expense of oil in Western Europe's and to a lesser extent, the United States' industrial market;

(4) increased OPEC sales of NGLs (500 mbd) which fall outside the OPEC crude oil quota system;

(5) the coming onstream of three large export refineries in Saudi Arabia, Algeria and Libya of over 800 mbd of capacity, and the prospect that an additional 1.1-1.4 mmbd of OPEC refining capacity will be built in the 1985-1990 period;

(6) cheating on OPEC prices by Nigeria and others through a variety of mechanisms (countertrade and netback deals) that are placing additional sizeable volumes of crude oil on the market;

(7) an end to inventory build-ups by some of the major oil companies;

(8) further slippage in demand in the first eight months of 1985 in Western Europe, Japan, and the United States, which has led several major oil companies to revise their world oil demand figures down dramatically;

(9) rising volumes of product exports from non-OPEC, as well as the OPEC producers noted above. These developments have led to an additional 1 mmbd of closings of U.S. refinery capacity since 1983, on top of 3 mmbd between 1981-1983 and the prospects of still more;

(10) increases above those projected in non-OPEC incremental oil production of 800 mbd in 1985 against a projected demand growth of 300-400 mbd, and the anticipation that new non-OPEC production will come on stream in the future;

(11) fluctuating exports by the centrally-planned economies of barter oil from client states, and OPEC, as well as small increases in East Bloc production, adding further to market instability;

(12) continued conservation;

(13) the flow of large volumes of sub-octane gasoline, gasohol and ethanol into the United States which has depressed the value of light products, especially gasoline.

These events, combined with the emergence of more Iraqi oil export outlets totaling 700 mbd in the near future, presage growing downward pressure on oil prices during the rest of 1985 and 1986. If the above events are coupled with a significant slowdown in world economic growth in the last half of 1985 and 1986, an official OPEC price drop to the $22-$23/bbl level or even lower remains a stark possibility. Likewise, were the Iran/Iraq war to come to an abrupt halt (which seems unlikely) further pressures by these two nations to increase oil exports by as much as 3 mmbd in one year to rebuild their economies could provide the coup de grace for oil price stability. Iraq has already demanded an increase in its quota of 800 mbd, which can only be partially met by Saudi and Kuwaiti reductions in the production of "war relief" crude. The key trouble period for OPEC will occur between the fall of 1985 and mid-June 1987; the stocking policies of the oil companies in the fall of 1986 will provide an indicator of future market trends. In short, there seems to be almost no plausible scenario that could lead to demand for OPEC crude oil being above the 16-17.5 mmbd range through the third quarter of 1987.

However, using the short-term outlook to predict oil and product prices and supplies in the medium-term may well focus attention on the wrong trends. Market observers have been severely humbled. After the events of 1973-74, and again after the fall of the Shah in January 1979, they seem to have forgotten a lesson of basic economics; that the higher the price of a commodity goes, the less demand there is for it. As an energy commodity rises in price, people will pursue other energy alternatives. With the advantage of hindsight, the changes in the pattern of energy usage have been staggering. Between 1979-84, oil imports plummeted 40 percent in the United States, 34 percent in Western Europe and 26 percent in Japan. As Christopher Flavin notes in a recent Worldwatch Report, these three areas accounted for 31 percent of the decline in world petroleum trade.[54] In the OECD nations, energy consumption fell by 36 percent between 1973-1979. In contrast to this situation, oil consumption in the rest of the world rose by 7 percent between 1979-84 despite the impact of the global economic recession.[55]

While these gains are extremely impressive, they have not occurred without massive costs:

(1) the mothballing or closing down of nearly 7-7.5 mmbd of refinery capacity worldwide;

(2) the looming prospect of major bankruptcies of some electric utilities, which embarked on high-cost coal and nuclear power plants to meet increases in demand projected in the early 1970s that never occurred, owing to consumer resistance to high prices. Forbes Magazine estimates that the United States may have squandered $100 billion in the nuclear power sector alone;

(3) a near-depression in parts of the oil service sector;

(4) a massive restructuring and truncation of the gasoline marketing business, which by reducing gasoline storage capacity and the number of stations available to consumers could add to public panic and shortages in the event of a supply shortfall if current trends continue;

(5) profound national security concerns about the ability of the U.S. refining industry, if current trends continue, to meet product demand in the event of a major military mobilization in even a "secondary" conflict theater. It would be extremely ironic if the Strategic Petroleum Reserve, on which the American taxpayers will have spent $16.7 billion by the end of fiscal 1985, could only be partially used because of inadequate domestic refining capacity. With several refineries in Western Europe dedicated to NATO use having recently closed, the Western Alliance could suffer grave consequences if the 4.5 mmbd future drawdown capability of the Strategic Petroleum Reserve could not be used to resupply Western Europe in a variety of conflict scenarios;

(6) a massive rise in the debt burden of many oil industry giants incurred in the course either of acquisitions or in fighting off unfriendly suitors. Not one dollar of this debt has added one drop of oil or gas to the nation's oil and natural gas reserve base.

Falling energy prices, according to Bankers Trust,[56] have led to a plummeting in U.S. expenditures for oil and natural gas drilling, from $40 billion in 1982 to $27 billion in 1984 and an estimated $24.3-23 billion in 1985, a decline in 1984 dollars of about 50 percent. Clearly, if oil prices fall further, oil and gas drilling in once-promising frontier areas in Alaska, the OCS, the North and Norwegian Seas, and elsewhere will fall, leading to declining reserve/production ratios as oil demand picks up in the 1990s. Far too few policymakers seem to understand that given the long lead times necessary to develop new oil fields, 1990 is already energy history. If a project is not underway today, it will not be in the marketplace by 1990.

The elasticity of demand for oil is determined by a wide variety of factors (taxation regimes, etc.) and is the subject of intense academic debate. Yet, if oil prices fall precipitously in the short run, it will be probable that high-cost conservation measures, such as the replacement of undepreciated energy-inefficient machinery, would be delayed or postponed.

To the extent that oil prices fall in the short run to a level that generates U.S. consumer complacency, evident in renewed interest in medium-sized cars, the nation will begin to lock itself into rising dependence on imported oil later in the 1990s. Because almost all non-OPEC oil production that can be exploited without driving prices down is already on the market, the overwhelming proportion of any increased oil demand will be supplied by OPEC. If conservation efforts stagnate, exploration expenditures continue declining, and oil prices crash to a level that places higher-cost energy investments in oil, nuclear and coal at risk, demand for OPEC oil will accelerate in the early 1990s rather than the mid-1990s.

Analysts who believe that a collapse in world oil prices would be a pure boon to the world's economy are naive. Even if existing oil investments in high-cost areas such as the North Sea or in Alaska were not scrapped or made uneconomic (either because of the complexity of the governing taxation regimes or the economics of particular fields which are less expensive to operate at a small loss than to close down completely), new investments would be curtailed. Generalizations about how oil production in high cost areas will be affected at various price levels can be misleading. The economics of a field brought into production during the high inflation years of 1979-80 will vary greatly from those brought into production in earlier years. In any event, at prices of $20 or less per barrel, new investment in frontier oil production will fall off precipitously.

Some energy forecasters have neglected the fact that when a commodity's price rises dramatically over a short period of time, demand can fall so rapidly that prices also fall, owing to the availability of too much productive capacity relative to changed market circumstances. There is little incentive to develop new productive capacity when demand has shrunk, unless an investment is already well underway.

In this regard, John Lichtblau's article "OPEC's Challenge: Surviving

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Until the Mid-1990s" in the May 13, 1985 issue of the Petroleum Intelligence Weekly is of interest.[57] Mr. Lichtblau notes that the displacement of OPEC crude by non-OPEC crude since the late 1970s occurred as the result of several unique factors, including the near-simultaneous opening of the three largest oil sources outside OPEC in the post-war period -- the North Slope, the North Sea and increased Mexican production. However, he fails to note that most of this new production was the result of exploration expenditures made before the first oil shock of 1973-74. Since 1973-74, the growth in new non-OPEC production, while significant, has been far less dramatic. While this statement may appear at variance with the recent report in the July 15, 1985 issue of the Petroleum Intelligence Weekly, that Norwegian and other non-OPEC oil production has risen much more rapidly than expected, note that PIW goes on to warn that maintaining peak production levels now may presage a steeper decline in non-OPEC oil production by the early 1990s. It appears that this may already be the case for oil production in Egypt, Malaysia, Norway and the United Kingdom.

While nearly 6.5-7 mmbd of non-OPEC crude supplies have been added to the world oil market since 1979, there is little reason to believe such additions will continue. By 1988-89, North Sea production will begin to decline, followed by North Slope Prudhoe Bay production in 1990-1991. Some new production in the Third World will come on stream, but it is impossible to see this amounting to more than an additional 1-1.5 mmbd between now and 1990.

There is little reason for complacency in light of these events because they are occuring against a backdrop of:

(1) a World Bank projected growth in OPEC and Third World oil demand of 5-7 mmbd by 1995;

(2) declining East Bloc oil production and exports;

(3) a 25 percent decline in the oil reserves of the United States and the USSR, and a 5 percent decline in Western Europe reserves over the last decade despite the North Sea find;

(4) sagging U.S., Australian and United Kingdom production (down 1.7 mmbd by 1990 and 2.5-3.5 mmbd by 1995);

(5) the prospect of major reductions in the growth of coal and nuclear power in many OECD nations after 1992 in the absence of major new orders and solutions to the acid rain and nuclear environmental issues;

(6) the transfer by the OECD nations of many smokestack industries (steel, basic chemicals, cement, glass, etc.) abroad, which could presage faster than anticipated rises in energy and oil consumption in parts of the Third World;

(7) the January 1985 EIA projection of U.S. oil imports of 7.38 mmbd in 1990 and 9.44 mmbd by 1995 (52.4 percent of consumption).

Moreover, too few policymakers in Washington seem to be paying attention to the effect that falling oil prices in the short run may have on medium-term energy supplies. Between 1963-73 world oil production grew by 25.5 mmbd at a cost of $76.2 billion ($3,000/bbl of productive capacity). In contrast, between 1973-83 world oil production grew by 6 mmbd at a cost of $420 billion ($70,000/bbl of productive capacity). What these figures clearly tell us is that it is becoming more expensive to find oil, the risks are rising exponentially and we are finding less of it.

Given the uncertainties of the short-term market, the following conclusions can be drawn. First, as long as fears of a price collapse or slow price erosion persist, commercial inventories will remain lean, and investments in new exploration and production both in and outside OPEC will fall, leading to an erosion over time in global reserve/production ratios. Consequently, it appears likely that by the mid-1990s, OPEC's real productive capacity will not be the 31 mmbd produced in 1979 but closer to 25 mmbd. This reduction will occur for several reasons: (1) sagging oil reservoir investments in the wake of falling petrodollar revenue, (2) the emergence of a truncated OPEC as four or five OPEC members use all their oil for internal consumption, and (3) neglect of oil producing facilities.

Furthermore, if oil prices fall dramatically, the economies of Indonesia, Mexico, Venezuela, Ecuador and Nigeria could be thrown into political and social upheaval -- endangering current oil production and leading to reduced investments in oil facilities.

If one accepts the direction of this analysis, by 1995 the demand for OPEC oil could hover in the 23-24 mmbd range, straining OPEC's 25 mmbd production capacity. In this case, a political upheaval in any major oil-producing country could send prices skyrocketing. This prognosis would be disturbing enough simply on the basis of supply and demand analysis, but unfortunately OPEC's oil pricing and production decisions do not occur in a vacuum. As we have seen in 1956, 1967, 1970, 1973-1974 and 1979-1980, they are deeply influenced by political events exogenous to the oil market. Likewise, even in major non-OPEC oil-producing nations such as Mexico, political upheaval could send shudders through the world oil market.

It is this prospect more than any other that leaves us dangerously exposed to another oil price shock during the early 1990s. The specter of another Arab-Israeli war, the spread of the Iran-Iraq war, the coming to power of anti-western Islamic fundamentalist regimes in Iraq, Kuwait, Saudi Arabia or the UAE, or even terrorist attacks against major oil installations are all factors that could tear asunder the economic assumptions of our supply and demand forecasts. They also raise serious questions about the wisdom of enhanced product import dependence on this volatile region.

Likewise, those who automatically assume that OPEC and especially the Gulf producers will tailor their production to meet world oil demand in the 1990s do so at their peril. The question we should be asking is, what if Saudi Arabia decides to avoid the financial excesses of the past and, when demand picks up, produces only 5-6 mmbd (not 9-11 mmbd) over the next decade? What if a new generation of leaders concerned about the erosion of their society's values by modernization and Westernization decide that their black gold belongs to Allah and should remain in the ground?

These factors, as well as the Third World debt burden largely brought on by the oil shocks of the 1970s, generate the need for continued policy action on the energy front. Those who dismiss the World Bank's projections of the growth of Third World energy demand as grossly inflated should ask themselves what the energy implications would be if the major debtor nations either repudiated their debts or, as a block, followed the Peru's example and announced that repayments will be limited to a percentage of export earnings. If the nations of Asia, Latin America and Africa could reduce their burden of debt servicing and resume economic growth at the levels of the early 1970s, what impact would this have on global oil supplies, especially if oil prices fell to $20 or less? Few analysts in the United States have paid enough attention to the social and political chaos that IMF austerity measures have imposed on the mass of the population in the Third World. With birth rates climbing at 3.5-4 percent per year, and energy demand rising at 1.3 percent for each percentage increase in economic growth, it is apparent that any constraints on energy supplies will lead to declining levels of personal energy consumption and falling living standards. Already in much of the Third World, basic living standards are below those that prevailed in the early 1970s.

While this analysis suggests that the halcyon days of OPEC may return in the mid-1990s, it in no way suggests either that OPEC's troubles are over in the short run or that, as we move towards the turn of the century, oil's role as a major fuel will remain predominant. The major uncertainties that plague both short and long term energy projections are 1) assumptions about world economic growth, 2) changing relationships in the GDP/energy coefficient in response to changing energy prices, and 3) the inability to project exogenous factors (political or social upheavals) that impact on world oil markets.

Clearly, if oil prices fall dramatically ($15/bbl) in the short to medium term, this will have an impact on the global crude oil and petroleum product supply/demand balance in the 1990s. The key question that makes future prognoses uncertain is how long prices could remain at $15/bbl before demand rose once again as coal, nuclear and other higher cost energy alternatives came under increased price pressure. Those analysts who have recently argued that rising oil product imports into the United States pose no threat to U.S. national security[58] have been overly influenced by current market trends (slowly eroding prices) and have neglected the potential impact on the U.S. refining industry of a collapse in crude oil prices in the short run followed by rising volumes of crude oil and petroleum product import dependence in the 1990-1995 period.

What does seem clear is that substantially lower oil prices, by reducing revenues for already financially-pressed OPEC governments, will increase incentives for these countries to market additional volumes of crude and product through a variety of mechanisms such as discounted crude, subsidized feedstock prices, providing low or zero cost energy to their refiners, granting tax holidays to joint venture partners, etc.

Those market forecasters who discount the prospect of crude oil prices falling to $15-$20/bbl in the short run should note the recent statements by Saudi officials threatening to place large additional volumes of oil on the already glutted world market and recent "conversations" between high-level Kuwaiti officials and senior U.S. Government personnel indicating that $17/bbl oil is now viewed as a distinct possibility.

The implications of these developments could be staggering, especially during 1985-88, when large volumes of additional light products from the new OPEC export refineries enter the market. A collapse in crude oil prices would in the short run lead to a further decrease in OPEC economic activity and falling petroleum usage, potentially placing an additional incremental refined product supply of 100-150 mbd (above the already projected 1988 incremental supply of 50-100 mbd[59] onto the world market, threatening further closures of U.S. refinery capacity. Furthermore, plummeting economic activity in the OPEC countries will further reduce American exports to these nations, leading directly to a loss of American jobs and indirectly to a further reduction in demand for petroleum products as more American companies go out of business.

The short-term implications of the above events become even more startling over time, as dramatized by the projected energy/supply balances released by EIA in its January 1985 Annual Energy Outlook:[60]

TABLE 7

THE U.S. OIL BALANCE
(Millions of Barrels per Day)

Year	1974	1978	1984	1985	1990	1995
Oil and NGL Consumption	16.65	18.85	15.71	15.77	16.74	18.00
Oil and NGL Production	10.50	10.33	10.38	10.50	9.73	8.48
Crude Oil Imports	3.24	6.36	3.44	4.33	5.23	6.69
Refined Product Imports	3.01	2.01	1.97	1.57	2.15	2.74
Total Oil Imports	6.25	8.37	5.38	5.89	7.38	9.44
Imports as % of Consumption	37.5%	44.4%	34.2%	37.3%	44.1%	52.4%

This forecast is EIA's middle-range case and assumes average refiner crude acquisition costs in 1984 dollars to be $28 in 1985, $29 in 1989, $30 in 1990 and $40 in 1995. In EIA's low-price case ($24 in 1985, $25 in 1990), oil imports rise by 1 million barrels per day in 1990 to 48 percent of U.S. demand. By 1995, U.S import dependency approaches a staggering 65 percent.[61] Hoveover, the EIA's projections of crude oil and petroleum product imports in 1990 and 1995 assume a constant ratio, which would not ensue if additional U.S. refinery closings occur. More closings mean that oil product imports as a percentage of total imports would soar, exacerbating U.S. dependence on nations with excess refinery capacity and on those willing to engage in non-market predatory pricing mechanisms.

G. Henry Schuler, Director of the Bartlett Council on Energy and National Security at the Georgetown Center for Strategic and International Studies, has noted that the implications of EIA's projections should be given serious consideration by the U.S. Commerce Department in its reply to the U.S. Senate request[62] to launch an investigation under Section 232 of the Trade Expansion Act, as to whether rising volumes of imported petroleum products pose a national security threat.

The EIA's projections indicate that:

- Imports of crude oil and refined products in 1985 are expected to equal the 1974 share of total U.S. oil demand that Secretary Simon found to be a threat to U.S. national security;[63]
- By 1990, crude and product imports are forecast in the EIA base case to gain the 1978 share that Secretary Blumenthal found to be an even clearer threat in 1979;[64]
- By 1995, such imports are forecast to exceed 52 percent of total U.S. demand, some 5 points worse than the previous peak of 47 percent in 1977. This would clearly endanger U.S. national security.

In light of the above statistics, it is interestng to note that, acting under Congressional mandate under Section 232 of the Trade Expansion Act of 1962, two previous Secretaries of the Treasury made authoritative rulings that dependence on oil imports threatened U.S. national security and recommended measures to increase the production of domestic energy resources.[65]

On January 14, 1975, Secretary of the Treasury Simon sent a memorandum to President Gerald Ford, declaring:

> As a result of my investigation, I have found that crude oil, principal crude oil derivatives and products, and related products from natural gas and coal tar are being imported in to the United States in such quantities as to threaten to impair the national security...I therefore recommend that appropriate action be taken to reduce [such] imports...to promote a lessened reliance upon such imports, to reduce the payments outflow and to create incentives for the use of alternative sources of energy to such imports.[66]

On March 14, 1979, Secretary of the Treasury Blumenthal sent a similar memorandum to President Jimmy Carter supporting his predecessor's conclusion and proclaiming that it was "even more valid today."[67]

In the ongoing debate about the degree to which rising volumes of petroleum product threaten U.S. national security, it is important to note that in drafting Section 232 of the Trade Expansion Act, the Congress took an all-encompassing view of national security, which has been sorely lacking in the studies on this subject to date:

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> For the purposes of this section [232 of the Trade Expansion Act] the Secretary and the President shall in the light of the requirements of national security and without excluding other relevant factors give consideration to domestic production needed for projected national defense requirements, the capacity of domestic industries to meet such requirements, existing availability of human resources, products, raw materials, and other supplies and services essential to the national defense, the requirements of growth of such industries and such supplies and services including the investment, exploration, and development necessary to assure such growth, and the importation of goods in terms of their quantities, availability, character and use as those affect such industries and the capacity of the United States to meet national security requirements. In the administration of this section, the Secretary and the President shall further recognize the close relation of the economic welfare of the Nation to our national security.[68]

The findings by Secretaries Simon and Blumenthal, combined with the EIA's projections of rising dependence on imported crude oil and petroluem products during the 1990s, demonstrate the danger of complacency that currently governs energy policy formulation. If energy is perceived to be a long-term security issue, then policies such as filling the SPR, ensuring adequate domestic refining capacity, and aiding the development of alternative technologies must be pursued across Administrations. While conservatives will bewail government intervention, citing the extreme costs of such actions, and liberals will assail the hardships sometimes unleashed by "free market" policies, both groups must remember that there are real financial costs associated both with implementing policies as well as not implementing them. The question is merely who in the society pays for these policies when the bill comes due.

Governments must act on the basis of the best information available to them to avoid wide fluctuations in energy policy. Ideological rhetoric advocating an energy "free market" (which has never existed) or government management (which has never worked) must be rejected in favor of basic policy goals which can be fine-tuned over time. One critical policy goal must be to ensure the continuation of adequate petroleum refining capacity to:

- ensure the availability of direct DOD demand to meet a crisis (1.5 - 2 mmbd for a mobilization of U.S. forces to 4.5 mmbd to mobilize all NATO's forces);[69]

- provide for indirect defense fuel needs in such key areas as semiconductor production, forging, etc.;
- ensure the ability to meet essential civilian needs (the running of defense plants, hospitals, police, etc.);
- meet some level of non-essential civilian demand following the imposition of austerity measures either through market or non-market mechanisms;
- process some level of U.S. crude oil imports that might not be cut off in a crisis.[70]

Given U.S. global military, political and diplomatic commitments, any discussion of this issue must include an analysis of the impact of a supply disruption not only on the U.S. economy but also on U.S. commitments to the IEA nations and NATO.

Renewed U.S. and allied dependence on Middle Eastern, especially Persian Gulf, crude oil and petroleum products in the 1990s poses a grave threat to Western security. It is here that the politics and economics of domestic energy issues, such as the economic health of the domestic refining industry, are inexorably linked to national security. The failure to enact programs to ensure that we never again become overly dependent on imported crude oil and petroleum products increases our vulnerability to international oil shortages and disruptions.

The links between domestic energy policy and national security policy are several. First, international competition for oil in times of a real or perceived shortage, as in the case of the 1979 Iranian crisis, strains political and diplomatic alliances as nations move unilaterally to secure access to vital energy supplies. One of the reasons for this is that actions which the United States may regard as necessary to preserve access to the Arabian Gulf nations' oil supplies may be viewed as confrontational by one or more members of the European Community, Japan, and the major oil-exporting states. Although it is difficult in 1985, given the existence of the world "oil glut" and falling gasoline prices, for policymakers to devote time to planning for the next crisis, the EIA's supply/demand balances for 1990 and 1995 raise vexing problems. First, as the market for oil begins to tighten in the 1990s, what are the implications for U.S. refiners if OPEC ties crude oil and petroleum product sales? If that occurred, the United States could be forced to take subsidized petroleum products, further undermining the profit margins of all domestic refiners. This could occur under the guise of the "free market." Alternately, if an oil supply disruption occurred for whatever reason, increased dependence on both imported crude oil and petroleum product imports could lead to serious economic disruptions in the OECD nations, especially given the fall-off in non-OPEC petroleum availability predicted for the 1990s.

Although quantitative predictions about the seriousness of oil supply disruptions in the 1990s are nearly impossible to make given the wide variety of scenarios that can be postulated, there can be no doubt that increased dependence on the Middle East for petroleum products and crude oil threaten the security of the United States. In their contributions to the 1979 assessment of Secretary Blumenthal under Section 232 of the Trade Expansion Act, both the Department of Defense and the CIA warned of the numerous threats that could be posed to oil supplies.[71]

> Many ideological disputes in the Middle East have the potential to escalate to armed conflict in a single country, on a regional scale with the Middle East, or could draw in powers outside the region.[72]
>
> There are a number of territorial and political disputes involving Middle Eastern oil-exporting nations that could escalate to armed conflict, including insurrections, guerrilla wars and more conventional wars.[73]

These assessments were echoed by Secretary of Defense Weinberger in his fiscal year 1986 authorization to the Congress:

> Causes of instability and conflict...are many: ethnic and religious cleavages, irredentism and territorial disputes, rivalries for regional power and domination, and economic fluctuations and grievances. Although many of these problems are rooted deep in the past...they have been exacerbated by the proliferation of technologically advanced weapons systems, and above all, by increased Soviet support -- both direct and through proxies -- for terrorism, insurgency and aggression.[74]

The Joint Chiefs of Staff reported in their Fiscal Year 1985 report on the current state of our global affairs:

> The Middle East and Southwest Asia contain a large percentage of the world's known petroleum reserves and oil production. Continued Free World access to the region and these oil resorces is a vital concern of the United States. Regional stability and the limitation of Soviet influence are also important U.S. security objectives for the area.
>
> Threats to the stability of this region are numerous and complex. Local disputes, fueled by religious and nationalist differences and complicated by social and political changes, have drawn many regional factions into armed conflict. Where possible, the Soviets have attempted to exploit these differences in ways inimical to the interests of the United States and its friends. Three major conflicts persist. Serious differences remain among factions in Lebanon. If not resolved, these differences could lead to even greater tensions in the region. In the Persian Gulf area, the Iran-Iraq war continues. This war could increase in intensity and scope, thus endangering other Gulf states and oil fields and threatening free passage through the Strait of Hormuz. In Afghanistan, the Soviets have established a strong, permanent military presence, increasing pressure on other nations in the region.[75]

These concerns of DOD and the Joint Chiefs of Staff were reiterated by former Secretary of State Kissinger in February 1985. According to Dr. Kissinger, if Iran were to win the war with Iraq, the consequences for oil supplies and prices would be incalculable:

> Iran especially would not hesitate to impose on a defeated enemy and its impotent neighbors the production cutoff that it accepted for itself in the 1970s. It would thereby achieve unilaterally what it has been urging on OPEC for years: sharply reduced production, greatly increased oil prices and a blackmail position vis a vis the industrial democracies. A victory for Iran would be as well a political disaster because it would enhance the prestige of the most radical version of Islamic anti-Western fundamentalism from Southeast Asia to the shores of the Atlantic Ocean.[76]

With tightening oil markets predicted for the 1990s, the OECD nations (Europe, the U.S., Japan, Canada, Australia, New Zealand) will once again become more dependent on the Middle East for crude oil supplies. As a number of OPEC nations cease to be oil exporters owing to rising internal demand, OPEC will become a truncated organization. In the new "streamlined" OPEC, the Persian Gulf states -- Saudi Arabia, Iraq, Iran, Kuwait, the United Arab Emirates and Qatar -- will increase their dominance of world oil trade. It should be remembered that 56 percent of the world's proven reserves lie in the states adjacent to the Persian Gulf, an area where sudden changes of regime and political upheaval are rampant. This shift in the balance of power in OPEC means that both Arab and overtly anti-American states such as Iran will enhance their control of world oil trade. Given the political legacy of this region over the last 12 years, the United States must not allow its petroleum dependence on this region to grow.

With further refining "rationalization" occurring around the world in response to market forces, the availability of North American refinery capacity to meet NATO needs in the 1990s is already generating concern.[76] While NATO planners note that NATO's overall dependence on the Gulf has dropped from 31 percent in 1979 to 13 percent in 1983, they are disturbed that this trend reversed itself in late 1984.[77] Likewise, from conversations with NATO and U.S. Department of Defense officials, it appears that military planners, especially in the U.S. Navy, in the U.S. Air Force and at NATO headquarters, are far from sanguine about the implications of increased NATO and OECD import dependence projected for the 1990s.[78]

These planners note that the large reductions in NATO's dependence on Persian Gulf oil between 1979-1983 occurred as the result of excess production capacity outside the Gulf, increased pipeline capacity to bypass the Strait of Hormuz, and continued surpluses and enhanced flexibility of NATO's refining capacity. These planners are concerned that the following events may reverse NATO's success in reducing dependence on the Persian Gulf:

- Continued attacks on crude oil and petroleum product pipelines by sub-national and government-sponsored terrorist groups;
- The recent planting of mines in the Red Sea -- a major crude oil and especially refined product sea route;
- The erosion of non-OPEC surplus crude oil productive capacity, making U.S. and European refiners in the future more dependent on OPEC crude;
- Closings of U.S., Canadian, Caribbean and European refineries.

Of special concern are the number of inland European refineries that have closed. With remaining European refineries increasingly concentrated along the coast, NATO defense analysts are concerned about:

- their greater vulnerability to attack, especially by terrorists;
- the implications in a crisis of growing foreign ownership of European and perhaps U.S. downstream markets, e.g. Kuwait's growing role in the European gasoline market;
- the physical security and declining production of the oil fields in Norway and Great Britain. Of special concern is how vulnerable these facilities are to terrorist or submarine attack;
- alarm over rising crude oil and product import dependence;
- the impact that further budget cuts in DOD's and NATO member countries' defense budgets can have on ensuring NATO's fuel requirements before and during a crisis, especially in the 1990s.[79]

A few NATO officials also expressed concern that the USSR might soon begin to dump increased volumes of refined products processed from barter crude oil deals with Iraq, Libya, Algeria, Angola, etc., into the European market.[80]

To address these problems, NATO's Petroleum Planning Committe, in April 1985, launched a major study, to be completed by late 1986, on the implications of changes in the global refinery market for NATO's fuel requirements. Despite NATO's concern, there are some critical issues that NATO still needs to address that will have profound implications for the U.S. refining industry.

Over the last 35 years, NATO's fuel policy has evolved to include three basic assumptions:[81]

- NATO member countries will share and, if necessary, collectively procure needed oil supplies;
- Western Hemisphere energy facilities both in NATO and non-NATO countries are considered in most scenarios to be available to meet Western defense needs. This makes NATO dependent on foreign oil, but not necessarily vulnerable;
- In almost all conflict scenarios, NATO assumes some European

refining capacity will be available, thus implicitly assuming that crude oil from the U.S. or other non-European sources will be refined in Europe.

The validity of these assumptions is highly questionable for the following reasons:

- Assuming that NATO's fuel requirements are cut off as a result of political events outside the area governed by the NATO treaty (e.g. the Persian Gulf), is it really likely that NATO will "collectively procure" Persian Gulf oil? What would happen if, as in 1973-1974, some of the European members of NATO have differences with U.S. policy in the region?
- If, as projected by the EIA, U.S. crude oil and petroleum product import dependence rises and domestic production falls in the 1990s, how much crude oil might the U.S. have to export to meet NATO and the United States' IEA obligations? Would such crude be available above U.S. requirements in light of a growing U.S. dependence on product vs. crude oil imports?
- Will Venezuelan, Canadian or Mexican crude and/or product be available in significant export volumes in 1990 and 1995?
- How would NATO's fuel needs be supplied if European refinery capacity were not available but was knocked out early in a conflict? In such a scenario, European NATO might need 2 - 3.5 mmbd of petroleum product to meet its needs.[82] Will it be available from the U.S.?
- With the closing of inland refineries and the concentration of key European refineries along the coast, are European and NATO product needs more or less secure in a conflict?

Reliance on insecure oil supplies impinges on the military security of the United States and its allies on several other fronts. First, safeguarding major oil-producing states against external attack or internal subversion necessitates difficult strategic choices. The military must have the bases and operational mobility to move quickly against the sabotage of energy logistics systems in the major energy-exporting countries and on the seas. The military must also position adequate fuel supplies for the defense of Europe, Japan and the United States, and to support allied interests in other conflict areas. The West's ability to support sufficient military forces in an era of fiscal austerity and high energy costs is another problem arena.

Even in peacetime, the military must have enough supplies of petroleum products to conduct several operations simultaneously, e.g. monitor Soviet ship movements, patrol vital Sea Lanes of Communication and protect access to oil facilities in the major oil-producing nations. Recently, the Office of the U.S. Chief of Naval Operations has expressed concern over the ability of the Navy to conduct such operations given shortages of fuel arising from budgetary constraints on fuel supplies.[83]

One of the key difficulties in assessing the nature of the threat posed by a supply disruption is that its impact can vary immensely depending upon size, cause and duration. Past U.S. disruptions have been relatively small in size, short in duration, and caused by political decisions. Yet these disruptions have caused immense economic dislocations. In 1979, a shortfall of 5 percent in supply caused major economic havoc, gasoline lines and global recession.

A major supply disruption with an open-ended time frame, resulting from such events as a Soviet occupation of the Persian Gulf, would severely impact the U.S. economy. Such a disruption might require the use of military force to restore oil supplies. Even if military force was precluded, the need to shift fuels to the civilian sector might result in reducing supplies to the military and affect the nation's ability to defend itself.

A 1980 Congressional investigation of defense petroleum supplies concluded that:

- Mobility fuel inventories were not sufficient to satisfy the Defense Department's peacetime operating requirements;
- In order to maintain peacetime operations it was necessary for the DOD to draw down its war reserve petroleum stocks, thus trading wartime sustainability for current readiness;
- DOD petroleum storage facilities were inadequate for wartime; and
- Invocation of the Defense Production Act during the 1973 Arab oil embargo was not adequate to receive priority use of available petroleum products.[84]

Although DOD has reduced overall petroleum demand by 5 percent since 1973-1974, it is important to note that this has been accomplished through conservation and fuel-switching at stationary fuel-burning facilities for heating and electric power generation. As Henry Schuler notes, "in the military significant category of mobility fuels, the Reagan Administration's increased emphasis on military preparedness and deployment has erased the savings that were achieved through development of more efficient engines in the late 1970s."[85] U.S. planes, ships and land vehicles now use more fuel than they used in 1975 when DOD expressed concern about supply interruptions in Secretary Simon's report. DOD's budget for petroleum in fiscal year 1984 was $7.6 billion, more than twice as large as in Fiscal Year 1978 when Secretary Harold Brown's concern was first raised about the impact of rising costs upon readiness.[86]

In this regard, it should be noted that Congressional authorization of a Defense Petroleum Reserve in 1975 has never been funded. Moveover, the Reagan Administration's policy of utilizing the SPR to alleviate civilian price pressures could well reduce the availability of the SPR for use by the military. Consequently, the DOD remains dependent upon domestic production and imported crude oil from friendly nations to meet its increased wartime requirement. This fact argues for ensuring that adequate domestic refinery capacity remains available to process that portion of imported crude oil that might remain available even given a political explosion in the Middle East.

One of the difficulties in assessing the vulnerability posed to U.S. security by foreign dependence on imported fuels is that seldom do military and civilian officials who run DOD agree on these issues. Too often, civilian officials express little or no concern either as the result of budgetary constraints or because weapon development receives higher priority.

This problem plagues DOD, as demonstrated by the formal recent statements of senior U.S. Defense Department officials and senior Pentagon personnel. While the testimony of Fred Ikle and Jeff Jones has exhibited little concern, the author was told in numerous private conversations with other DOD officials that fuel supply constraints severely limited our wartime readiness.[87] Clearly, if vital petroleum product stocks are vulnerable today, one must ask what would happen if more independent refiners, who currently supply 50 percent of DOD requirements, are shut down due to rising volumes of imported oil products over the next several years.

Economic Security

The economic security of the U.S. and its allies also remains threatened, as mentioned by Secretaries Simon and Blumenthal, by huge oil import bills. These bills strain the ability of the international banking system to recycle petrodollars from creditor to debtor nations, thus raising the specter of severe worldwide economic depression, if not global economic collapse. Oil payments represent a massive transfer of real wealth from energy-deficient nations to energy-surplus nations.

There is currently a complacent attitude regarding oil imports given the lower level of U.S. oil imports. In terms of 1978 dollars, when Federal Reserve Chairman Miller warned about the dangers posed by our $43 billion oil import bill, oil imports in 1984 are $42 billion ($64 billion in actual dollars). Imported energy costs are 50 percent higher than the net earnings of the nation's three largest exports combined -- agricultural products ($20 billion), chemicals ($10 billion) and non-electric machinery ($9 billion). In 1984, the U.S. - OPEC merchandise trade deficit of $13.7 billion accounted for 11 percent of the total deficit.[88]

Given the overwhelming economic havoc that the cost of oil imports continues to exert on the U.S. and world economies, the wisdom of allowing greater dependence on imported petroleum products must be questioned.

Summary

The market changes occurring in the international crude oil market, coming in concert with growing U.S. dependence on imported petroleum products and crude oil from insecure sources, pose grave challenges to U.S. national security.

As noted throughout this report on two previous occasions in 1975 and 1979 the U.S. Government found that levels of crude oil and petroleum product import dependency had reached levels that threatened U.S. national security. On the basis of the market developments highlighted in this report, by 1990 U.S. crude oil and petroleum product import dependency will equal or surpass the level that the earlier findings found detrimental to U.S. security.

Furthermore, we must act now to alter that result in 1990 and even higher levels of dependence in 1995.

Given this fact, one must question the wisdom of allowing greater import dependency to occur on an ad hoc basis. For the past twelve years, U.S. Government policy has been to reduce our dependence on insecure sources of oil through a variety of market and non-market mechanisms. Our failure to continue these efforts, even in a period of relative market tranquility, will endanger the long-term security of the nation.

ENDNOTES

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32. Ibid., pp. 15-16.

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35. Ibid.

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42. Ibid.

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66. See Endnote 63.

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74. *Report of the Secretary of Defense to the Congress on the FY 1985 Budget, FY 986 Authorization Request and FY 1985-1989 Defense Programs*, February 1, 1984, p. 19.

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82. See Endnote 69.

83. Interview with Office of Chief of Naval Operations, Washington DC, August 1985.

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Mr. PEASE. Very well. Thank you very much.

Mr. Potter, we will hear from you now.

STATEMENT OF NORMAN D. POTTER, SENIOR VICE PRESIDENT, WARREN PETROLEUM CO., ON BEHALF OF THE SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

Mr. POTTER. My name is Norman D. Potter. I am senior vice president of Warren Petroleum Corp. I appear here today on behalf of the Society of Independent Gasoline Marketers of America, of which Warren Petroleum Corp. is a member. I appreciate this opportunity to testify before you today in support of H.R. 2396 and in opposition to H.R. 2354.

I plan to summarize my testimony and submit the complete text for insertion in the record.

As a trade association comprised of approximately 280 independent marketers and chain retailers of motor fuels, SIGMA's members market motor fuels in all 50 States and their sales account for approximately 15 percent of the domestic retail market for motor gasoline.

Independent marketers, such as SIGMA's members, have been recognized as being the world's most efficient retailers of motor fuels. These companies historically have been the most innovative and price-competitive segment in the retail motor fuels market.

Independent marketers compete directly with one another as well as the downstream marketing and retailing operations of refiners. Indeed, independent marketers' impact on price competition and the marketplace, in general, has been beneficial in several ways. Because of greater efficiencies and superior systems of cost controls, independent marketers have played a critical role in inducing price competition in the domestic market.

And, in addition, independent marketers supply most of the refined products in the geographic areas bounded by major refiners.

SIGMA's members must rely upon the procompetitive effects generated by relatively unrestricted access to finished gasoline and gasoline blendstocks of foreign manufacture. The potential alternate supply, which such access represents, constitutes the principal incentive for integrated domestic refiner marketers to sell competitively priced product to their marketer competitors. Without this incentive, competition at the retail level of the gasoline market will be reduced significantly.

SIGMA strongly supports the enactment of H.R. 2396. This bill would correct the current anomaly in the U.S. tariff structure which places a higher tariff on motor fuel blendstocks than those imposed on finished gasoline. This situation effectively discourages the manufacture of gasoline in the United States, which is contrary to the well-established objective of the TSUS to promote domestic manufacturing.

H.R. 2396 is similar to a bill from the 98th Congress, H.R. 5754, which was reported by the Ways and Means Committee. However, during the House-Senate conference, the House receded and requested a study on the issue from the International Trade Commission. The ITC has completed its investigation, and its report supports the concept of H.R. 2396.

The tariff treatment of commodities which are used as motor fuel blending stocks has created substantial uncertainty regarding the tariff obligations to which domestic companies will become liable by importing commodities to be used as motor fuel blending stocks.

For example, if an independent marketer contracts to import gasoline from a foreign source, the marketer anticipates a tariff rate of $0.0125 per gallon. However, foreign-made gasoline frequently enters U.S. Customs and fails to meet specifications required by the United States to be classified as gasoline and bc tariffed at a rate of $0.0125 per gallon. Instead, it is classified as a chemical mixture and a tariff of up to 17.3 percent ad valorem is imposed. That is a substantial and critical difference to an independent gasoline marketer who competes in a market where a penny per gallon make a difference in competitive viability.

H.R. 2396 would eliminate these problems by creating a separate item in the tariff schedules for motor fuel blending stocks. Classification of a blending stock would be based upon the actual use of the commodity to manufacture motor fuel. SIGMA is aware that the chief use criterion is more common in the TSUS. However, when nomenclature issues threaten to impede the implementation of a rational tariff policy, Congress has elected to employ an actual use criterion.

Some examples of actual use classifications include TSUS item numbers 480.05, limestone; 357.25, woven tapestry fabrics; and 131.37, oats. A review of these examples illustrates not only the fact that actual use classifications are incorporated in the U.S. tariff schedules, but also that they are used in the classification of a wide variety of imported articles. Thus, there is ample precedent for the actual use approach adopted in H.R. 2396.

In summary, enactment of H.R. 2396 will achieve several desirable objectives: One, it will eliminate an inverted tariff structure and thereby eliminate the incentive to manufacture finished products offshore rather than in the domestic economy; two, it will provide certainty to importers of blendstocks and the customers who depend upon such importers' manufacturing activities for sources of supply; three, it will eliminate the obvious inequity in the tariff schedules without affecting the duty applicable for commodities which were not used as motor fuel blending components; and four, it will achieve these objectives without imposing injury on any segment of the domestic economy. H.R. 2396 should be enacted.

SIGMA strongly opposes the enactment of H.R. 2354. Enactment of this legislation is unnecessary and would be anticompetitive and anticonsumer. As I have mentioned earlier, SIGMA's members are dependent upon third parties for their supply of products.

The overwhelming proportion of the product purchased by SIGMA's members is obtained from domestic refiner marketers, with whom SIGMA's members also compete, directly or indirectly, at the retail level. Historically, access to supplies of gasoline and blendstocks from foreign manufacturers has prompted competition and has served as the chief incentive for domestic refiners, both integrated and independent, to supply products to their customers at a competitive price.

H.R. 2354 is essentially protectionist legislation for the domestic refining industry that is not needed or warranted.

Imports of gasoline and gasoline blendstocks have not significantly weakened the domestic refining industry. The United States is not becoming dangerously dependent on imports of refined petroleum products. Finally, imports of gasoline and gasoline blendstocks have not been the predominant cause of refinery closings in the United States.

SIGMA does not dispute the fact that some domestic refiners, predominantly independent refiners, may have experienced financial difficulties since the end of Federal price and allocation controls.

SIGMA is sympathetic to independent refiners. In fact, many SIGMA members have close supplier customer relationships with independent refiners. Nevertheless, the overwhelmingly dominant cause of independent refiners' problems is not imports but rather the fact that they compete with vertically integrated entities which have access to their own crude oil, which are substantially stronger economically and which, because of greater diversification, are better able to survive severe market fluctuations.

It has been alleged that imports of gasoline blendstocks have weakened the domestic refining industry, resulting in a substantial loss of jobs. This allegation is unsustainable. The combined market share of imported gasoline and imported gasoline blendstocks is well under ten percent. No credible causal relationship can be established which links the reining decrease and subsequent loss of jobs which the United States has experienced to such a small amount of imports.

The relatively recent refinery closings in the United States have been the result of a global market contraction, which has rendered inefficient refining capacity unviable. The reduction in refining capacity does not stop at our borders. For example, West Germany has experienced a 40-percent decrease in refining capacity since the late 1970's. The world refining industry is decreasing due to a global decrease in demand. In addition, contraction of worldwide refinery capacity is occurring because of a change in the mix that is being demanded. Refiners which are geared to producing products toward the heavy end of the barrel either must modernize or close.

It also has been alleged that imports of refined petroleum products are undermining our national security. Several committees of this Congress have entertained debates on current operable refining capacity and the ability to meet refining demands during a national crisis. The Departments of Defense, Energy, and Commerce have consistently stated that domestic refining capacity is adequate to meet the United States' national security needs.

The argument that increased dependence on imports of refined petroleum products renders this country susceptible to the type of economic blackmail practiced in the Arab oil embargo strains credulity. The principal sources of gasoline and motor fuel blendstock imports are not adversaries of the United States, but rather close allies and, in most instances, close geographic neighbors.

Thus, it would be irrational to increase domestic inflation, domestic refiners would be able to increase their prices for gasoline by the amount of the increased tariff, and adversely affect the structure of the gasoline market to the detriment of consumers, in an effort to protect ourselves fom countries like Canada, Brazil, Venezuela, the Netherlands, or the United Kingdom.

H.R. 2354 should not be enacted. H.R. 2354 is anticonsumer, inflationary, and unnecessary. It is bad economic policy and bad trade policy.

SIGMA appreciates this opportunity to express its views on H.R. 2396 and H.R. 2345. I will be happy to respond to any questions which my testimony may have raised. Thank you very much.

[The prepared statement follows:]

STATEMENT OF NORMAN D. POTTER, ON BEHALF OF THE SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

My name is Norman D. Potter. I am Senior Vice President of Warren Petroleum Corporation. I appear here today on behalf of the Society of Independent Gasoline Marketers of America, of which Warren Petroleum Corporation is a member. I appreciate this opportunity to testify before you today in support of H.R. 2396 and in opposition to H.R. 2354.

SIGMA is a trade association comprised of approximately 280 independent marketers and chain retailers of motor fuels. SIGMA's members market motor fuels in all 50 states and their sales account for approximately 15 percent of the domestic retail market for motor gasoline.

BACKGROUND

Independent marketers, such as SIGMA's members, have been recognized as being among the world's most efficient retailers of motor fuels. These companies historically have been the most innovative and price-competitive segment of the retail motor fuels market. As such they are an essential component of competition in the domestic retail market for motor fuels.

Independent marketers compete directly with one another as well as the downstream marketing and retailing operations of refiners. Indeed, independent marketers' impact on price competition and the marketplace in general has been beneficial in several ways. Independent marketers have introduced innovative marketing devices like self service, high volume/low margin marketing, and automated retail marketing. Because of these pioneering marketing concepts and superior systems of cost controls, independent marketers have played a critical role in inducing price competition in the domestic market for gasoline. In addition, independent marketers supply most of the refined products in many of the geographic areas abandoned by major refiners.

Independent marketers' lack of crude oil production or processing capacity means that refined product supplies must be secured from domestic competitors or from imports. Prices at which independent marketers can obtain refined petroleum products are critical. Absent the availability of competitively-priced products, the superior efficiencies and innovations of independent marketers are rendered irrelevant in the market and independent marketers could not survive.

Access to imports of gasoline and gasoline blendstocks serve an important function beyond mere addition to supply. First, imports provide independent marketers with another source of competitively-priced gasoline. Second, the availability of gasoline of foreign manufacture to participants in the U.S. market induces competitive pricing by domestic refiners who otherwise would have no incentive to deal on a competitive basis with their marketer-competitors.

In sum, for their economic and competitive viability, SIGMA's members must rely upon the pro-competitive effects generated by relatively unrestricted access to finished gasoline and gasoline blendstocks of foreign manufacture. The potential alternate supply, which such access represents, constitutes the principal incentive for integrated domestic refiner-marketers to sell competitively-priced product to their marketer-competitors. Without this incentive, competition at the retail level of the gasoline market will be reduced significantly.

H.R. 2396

SIGMA strongly supports the enactment of H.R. 2396. This bill would correct the current anomaly in the U.S. tariff structure which places a higher tariff on motor fuel blendstocks than those imposed on finished gasoline. This situation effectively discourages the manufacture of gasoline in the U.S., which is contrary to the well-established objective of the TSUS to promote domestic manufacturing.

H.R. 2396 would eliminate the inequitable and counterproductive relationship between the tariffs imposed on those products used as blendstocks or components to manufacture motor fuels and the tariff imposed on finished motor fuel itself. Moreover, this objective would be achieved in complete conformity with the technical recommendations of the International Trade Commission ("ITC") in its report on this issue, *Possible Effects of and Recommendations Concerning the Proposed Tariff Reclassification of Catalytic Naphtha and Other Motor Fuel Blending Stocks.*[1]

As noted in the ITC's Report, current tariff treatment of catalytic naphthas and other motor fuel blending stocks constitutes an inverted tariff structure resulting in the components of a product being subject to a duty which is higher than that imposed on the finished product. Under current U.S. Customs Service interpretations of the tariff schedules, some commodities, imported for use as motor fuel blending stocks, are subject to a tariff rate dramatically greater than the rate imposed upon the product motor fuel. For example, catalytic naphtha currently is treated as an alkylbenzene mixture subject to a tariff of 0.6 cents per pound plus 17.3 percent ad valorem under TSUS Item No. 402.36. This tariff substantially exceeds the rate of $.525 per barrel imposed on finished motor fuel ($.0125 per gallon).

The tariff treatment of commodities which are used as motor fuel blending stocks has created substantial uncertainty regarding the tariff obligations to which domestic companies will become liable by importing commodities to be used as motor fuel blending stocks. For example, if an independent marketer contracts to import gasoline from a foreign source, the marketer anticipates a tariff rate of $.0125 per gallon. However, foreign-made gasoline frequently enters U.S. Customs and fails to meet specifications required by the U.S. to be classified as gasoline and be tariffed at a rate of $.0125 per gallon. Instead, it is classified as a chemical mixture and a tariff of up to 17.3-percent ad valorem is imposed. That is a substantial and critical difference to an independent gasoline marketer who competes in a market where mills per gallon make a difference in competitive viability.

H.R. 2396 would eliminate these problems by creating a separate item in the tariff schedules for motor fuel blending stocks. Classification of a blending stock would be based upon the actual use of the commodity to manufacture motor fuel. SIGMA is aware that the chief use criterion is more common in the TSUS. However, when nomenclature issues threaten to impede the implementation of a rational tariff policy, Congress has elected to employ an actual-use criterion. Some examples of actual-use classifications include TSUS Item Nos. 480.05 (limestone), 357.25 (woven tapestry fabrics), and 131.37 (oats). A review of these examples illustrates not only the fact that actual use classifications are incorporated in the U.S. tariff schedules, but also that they are used in the classification of a wide variety of imported articles. Thus, there is ample precedent for the actual-use approach adopted in H.R. 2396.

In summary, enactment of H.R. 2396 will achieve several desirable objectives: (1) it will eliminate an inverted tariff structure and thereby eliminate the incentive to manufacture finished products offshore rather than in the domestic economy; (2) it will provide certainty to importers of blendstocks and the customers who depend upon such importers' manufacturing activities for sources of supply; (3) it will eliminate the obvious inequity in the tariff schedules without effecting the duty applicable for commodities which were not used as motor fuel blending components; and (4) it will achieve these objectives without imposing injury on any segment of the domestic economy. Thus, enactment of H.R. 2396 would achieve several desirable goals at no cognizable cost to the economy or the consumer. H.R. 2396 should be enacted.

H.R. 2354

SIGMA strongly opposes the enactment of H.R. 2354. Enactment of this legislation is unnecessary and would be anti-competitive and anti-consumer. This legislation would increase tax on imported gasoline from the current $.525 per barrel to 10.8 percent ad valorem for the first 3,000,000,000 gallons of gasoline imported, and 21.6 percent ad valorem for imports in excess of 3,000,000,000 gallons. Enactment of this bill would effectively foreclose foreign gasoline from the U.S. market.

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[1] Final report on Investigation No. 332-203 Under Section 332(g) of the Tariff Act of 1930, USITC, Pub. No. 1686, *Possible Effects of and Recommendations Concerning the Proposed Tariff Reclassification of Catalytic Naphtha and Other Motor Fuel Blending Stocks* (April 1985) (hereinafter "ITC's Report").

As noted above, because SIGMA's members do not produce or process crude oil, they are dependent upon third parties for their supplies of product. The overwhelming proportion of the product purchased by SIGMA's members is obtained from domestic refiner-marketers, with whom SIGMA's members also compete, directly or indirectly, at the retail level. Historically, access to supplies of gasoline and blendstocks from foreign manufacturers has promoted competition and has served as the chief incentive for domestic refiners, both integrated and independent, to supply products to their customers at competitive prices. Thus, imported motor fuels and motor fuel blending stocks serve as an essential component of competition in the domestic motor fuels market.

In his remarks accompanying the introduction of H.R. 2354, Congressman Anthony stated that enactment of this legislation is justified for the following reasons: (1) "This country's increasing dependence on foreign refined petroleum products especially motor gasoline, weakens a vital domestic industry and undermines our ability to employ the strategic petroleum reserve [SPR] in the event of a substantial energy supply interruption;" (2) our "national dependence on imported refined products is rapidly replacing our historical dependence on imported crude oil;" and (3) "[i]ncreasing imports of gasoline and gasoline blendstocks have forced the shutdown of many efficient U.S. refineries." SIGMA respectfully disagrees with the Congressman.

Imports of gasoline and gasoline blendstocks have not significantly weakened the domestic refining industry. Such imports do not significantly undermine our ability to process the SPR. The United States is not becoming dangerously dependent on imports of refined petroleum products. Finally, imports of gasoline and gasoline blendstocks have not been the predominant cause of refinery closings in the United States.

SIGMA does not dispute the fact that some domestic refiners, predominantly independent refiners, may have experienced financial difficulties since the end of federal price and allocation controls. Like all segments of the oil industry refiners have enjoyed highly profitable operations during certain market situations, and incurred losses during other times.

A review of the relevant facts demonstrates that any recent losses result from causes other than imports of gasoline and gasoline blendstocks. The following Table A is a representation of the total refineries that were closed during the period January 1, 1981 through December 1984, according to barrels produced per calendar day.

TABLE A-3

Capacity	Number of refineries	Percentage of total
Over 100,000 B/CD	5	4.5
30,001 to 100,000 B/CD	13	11.6
10,001 to 30,000 B/CD	38	33.9
10,000 or less B/CD	56	50.0
Total	112	100.0

Many of the refineries that have closed since 1981 had been built in reliance upon the continued existence of the Mandatory Petroleum Price and Allocation Regulations which provided substantial cost subsidies to small refiners. The overwhelming preponderance of other closed refineries were plants of insufficient efficiency to render them economically viable in a deregulated, highly-competitive market. Finally, it must be recognized that these refinery closings reflect a logical adjustment to the substantial decrease in demand for gasoline which developed after the Iranian embargo of 1979.

SIGMA is sympathetic to independent refiners. In fact, many SIGMA members have close supplier-customer relationships with independent refiners. Nevertheless, the overwhelmingly dominant cause of independent refiners' problems is not imports, but rather the fact that they compete with vertically-integrated entities which have access to their own crude oil, which are substantially stronger economically and which, because of greater diversification, are better able to survive severe market fluctuations. As noted by Mr. Anthony in his remarks which accompanied H.R. 2354, vertically-integrated natural resource companies' profits are not susceptible to measurement by normal accounting standards. [2]

It has been alleged that imports of gasoline blendstocks have weakened the domestic refining industry, resulting in a substantial loss of jobs. This allegation is unsustainable. The combined marketshare of imported gasoline and imported gasoline blendstocks is well under 10 percent. No credible causal relationship can be established which links the refining decrease and subsequent loss of jobs which the U.S. has experienced to such a small amount of imports.

The relatively recent refinery closings in the U.S. have been the result of a global market contraction, which has rendered inefficient refining capacity unviable. The reduction in refining capacity does not stop at our borders. For example, West Germany has experienced a 40-percent decrease in refining capacity since the late 1970s. The world refining industry is decreasing due to a global decrease in demand. In addition, contraction of worldwide refinery capacity is occurring because of a change in the mix that is being demanded. Refineries which are geared to producing products toward the heavy end of the barrel either must modernize or close.

Moreover, this market contraction has generated intense competition between domestic integrated oil companies which, in an effort to increase marketshare to support utilization of their refining assets, have depressed refined petroleum product prices. The ability of such companies to remain highly profitable while sustaining this action, *i.e.*, profits from other activities, is absent in the case of independent refiners. If foreign refiners were, in fact, willing to "give away" refined products in an effort to move their crude oil or maximize utilization of their refineries, it is inconceivable that their share of the domestic market would remain as low as it has. Rather, it is clear that foreign gasoline producers have no greater incentive to "give away money" then do their domestic integrated competitors. Rather, the pricing of imported gasoline reflects only the foreign producer's need to meet the competition of its domestic integrated competitors in order to participate in the domestic market.

It also has been alleged that imports of refined petroleum products are undermining our national security in two ways: (1) by driving out of business domestic refiners whose refining capacity is necessary to process our domestic crude oil production and Strategic Petroleum Reserve; and (2) by increasing our dependence on products of foreign manufacture and thereby rendering the United States susceptible to an embargo similar to that of the early mid-1970s. Several committees of this Congress have entertained debates on current operable refining capacity and the ability to meet refining demands during a national crisis. The Departments of Defense, Energy and Commerce have consistently stated that domestic refining capacity is adequate to meet the United States' national security needs. In fact, at a December 5, 1985 hearing before the House Armed Services Subcommittee on Readiness, spokesmen for the aforementioned Departments categorically denied that imports of petroleum and petroleum products pose a threat to national security. Specifically, Jeffrey A. Jones, Deputy Director of Energy Programs for the Department of Defense, stated:

"Petroleum demands for national defense are small compared to civil demand. In an emergency, Defense demand would be met. Therefore, determining the adequacy of the refining base to meet national demand rests on economic assumptions and policies.

"DoD is a marginal customer of the petroleum industry. As such DoD benefits from conditions of excess refining capacity, which prevail at the moment."

The argument that increased dependence on imports of refined petroleum products renders this country susceptible to the type of economic blackmail practiced in the Arab oil embargo strains credulity. As Table C (attached) demonstrates, the principal sources of gasoline and motor fuel blendstock imports are not adversaries of the United States, but rather close allies and in most instances, close geographic neighbors. In addition, the actual level of product imports simply do not support the allegations that imports are flooding the domestic market. Imports and import penetration of all finished petroleum products have decreased steadily over the first three quarters of 1985, while U.S. demand actually increased. Import penetration as a percentage of domestic consumption declined from 8.7 percent in the second quarter, to 7.6 percent in the third quarter. Similarly, import penetration of motor gasoline including blending components has decreased from the second quarter to the third quarter of 1985, from 7.4 percent of U.S. consumption to 5.8 percent. Import penetration decreased again in October 1985 to 5.6 percent of U.S. consumption.[3]

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[2] Table B (attached), illustrates that the chief proponents of import restrictions are refiners who base their pleas on claims that their market share is being lost to imports of gasoline and motor fuel blendstocks. However, during the months November 1984 through October 1985, refiners were responsible for a substantial percentage of the imports of such products, i.e., a low of 34.30 percent in July 1985 to a high of 52.96 percent in January 1985.

It would be irrational to increase domestic inflation (domestic refiners would be able to increase their prices for gasoline by the amount of the increased tariff), and adversely affect the structure of the gasoline market to the detriment of consumers, in an effort to "protect" ourselves from countries like Canada, Brazil, Venezuela, the Netherlands, or the United Kingdom.

H.R. 2354 should not be enacted. H.R. 2354 is anti-consumer, inflationary and unnecessary. It is bad economic policy and bad trade policy.

SIGMA appreciates this opportunity to express its views on H.R. 2396 and H.R. 2345. I will be happy to respond to any questions which my testimony may have raised.

TABLE B.—U.S. IMPORTS OF THE MOTOR GASOLINE AND GASOLINE BLENDING COMPONENTS, TOTAL IMPORTS AND IMPORTS BY REFINERS, NOVEMBER 1984 TO OCTOBER 1985

[Quantity in barrels]

	Gasoline	Gasoline blending components	Total	Total imported by refiners	Percent imported by refiners
1984:					
November	8,634,383	2,680,412	11,314,795	4,510,655	39.87
December	8,883,284	1,680,282	10,563,566	4,613,638	43.68
1985:					
January	6,569,484	1,626,151	8,195,635	4,340,344	52.96
February	10,256,691	3,107,163	13,363,854	5,427,778	40.52
March	14,832,486	2,407,978	17,240,464	6,475,133	37.56
April	15,269,268	2,315,300	17,584,568	7,347,325	41.78
May	15,567,735	2,780,705	18,348,440	7,716,509	42.06
June	11,548,997	1,185,893	12,734,890	5,889,211	46.24
July	14,397,025	1,743,528	16,140,553	5,536,999	34.30
August	9,823,059	1,627,579	11,450,638	5,564,258	48.59
September	9,640,007	1,290,806	10,930,813	4,588,741	41.98
October	10,676,986	1,491,122	12,168,108	4,587,726	37.70
12-month average (Nov. 1984 to Oct. 1985)	11,341,617	1,994,743	13,336,360	5,549,860	41.61

Source: Compiled from official statistics of the U.S. Department of Energy, Office of Oil Imports. Published by the American Petroleum Institute.

TABLE C.—U.S. IMPORTS OF MOTOR GASOLINE, 1985

Country	Quantity (barrels)	Customs value (thousands)
Venezuela	18,270,527	$581,262
Netherlands	17,897,424	554,857
Canada	14,874,536	483,512
Italy	13,681,151	412,015
Brazil	9,937,830	306,443
China	7,279,200	210,423
United Kingdom	5,562,314	173,716
Saudi Arabia	1,384,605	46,731
Romania	978,825	28,898
Other	37,219,110	1,166,417
Total	127,085,522	3,964,274

Source: Official Statistics of the U.S. Department of Commerce (TSUSA No. 475.2524 and 475.2528).

Mr. PEASE. Thank you very much, Mr. Potter.

Mr. Schulze, do you have questions?

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[3] Source: U.S. Department of Energy, EIA, Petroleum Supply Monthly, January 1985–October 1985.

Mr. **Schulze**. Mr. Chairman, I have no questions. I would like to welcome Norm Potter before the committee again. Norm is an old friend and former constituent, and I guess a former constituent before I was a Member of Congress. But we are always pleased to have him here to testify on such a great topic. Thank you very much.

Mr. **Potter**. Good to see you again.

Mr. **Pease**. Mr. Bragg, what is the volume of imported gasoline in comparison with total domestic consumption of gasoline?

Mr. **Bragg**. If you talk about finished gasoline, as well as the blending components, it is actually running somewhere in the neighborhood of less than 10 percent. It has been increasing consistently over the last few years, stabilizing somewhat in 1985, until December, when we saw a dramatic surge in the increase in imports again in December 1985.

Our difficulties are not with the volume, our difficulty is the fact that in the petroleum marketplace, the price is set on the marginal barrel. So it is really not a matter of whether it is 10 percent or 50 percent. If it represents the marginal barrel, as it has, then that is going to drive the price down dramatically.

We have made the case before you, in discussing different legislation, natural resource legislation, that we have a situation where we believe undervalued product is coming in, and we have supported the natural resource legislation of Mr. Gibbons in an effort to try to provide ourselves with the long-term support that we would need to make a case before the ITC.

However, in the short term, what we have found is major disruptions in the marketplace, which is what prompted us two summers ago to come before this subcommittee and begin the discussions about legislation that was being considered at that time.

Mr. **Pease**. Is there any evidence, then, that some of these foreign suppliers are dumping gasoline or gasoline blending stock in this market below their own cost of production?

Mr. **Bragg**. We have retained what we consider to be the best trade counsel we could find and asked them that question. This is a new arena for the independent refiners and the advice they have given us in dealing with technical terms under the existing law it would be extremely difficult to prove technically the term "dumping" and that we would be, based upon the experience that other industries have, very unlikely to secure any relief or prove that case, because we would have tremendous difficulty in getting into the economics of the producing countries to even begin to determine that, yes.

Mr. **Potter**. Mr. Chairman, might I comment on that question?

Mr. **Pease**. Surely.

Mr. **Potter**. We are an importer of foreign products. Our contract with our foreign refiner, the prices are based on a basket of escalators that are accepted throughout the world, and those prices rest competitive with both the domestic and foreign refiners. Most of them are related to the New York harbor price, and that is the basis of our contract buying price with our offshore refiner.

Mr. **Pease**. Is this legislation a violation of GATT, or would it be? Do either of you have any comments on that?

Mr. **Potter**. I am sorry, I didn't hear your question.

Mr. **Pease**. There is some suggestion this legislation might be in violation of the General Agreement on Trade and Tariffs.

Mr. **Bragg**. The information we received from our trade council is that there is no final decision as to whether or not there is a violation of GATT. A case can be made either way.

Mr. **Pease**. In the briefing book we have, it's stated that the proponents of the legislation or the sponsor considered in the drafting of H.R. 2354 recommendations of the United States International Trade Commission. I am not sure to what that refers. Would either one of you know, did the ITC ever make any recommendation that there ought to be an increase in the tariff?

Mr. **Potter**. No, sir, they do not in the report.

Mr. **Bragg**. No. My testimony did not go to the increase in the tariff.

Mr. **Pease**. It was not your testimony at all.

Mr. **Bragg**. Their comments address specifically the questions of actual use versus chief use and the inclusion of both finished gasoline and motor fuel blending materials in making their recommendations which are incorporated into the Anthony bill.

Mr. **Potter**. Mr. Chairman, in response to your earlier question, I would read into the record some ITC comments to the committee, if you would like. It says, "To the extent that duty rates on any of these products are increased, the United States likely would be viewed as violating previous trade agreement concessions made under the auspices of the General Agreement on Tariffs and Trade."

Mr. **Pease**. OK. Very good. Mr. Frenzel?

Mr. **Frenzel**. No questions, Mr. Chairman.

Mr. **Pease**. All right. Fine. Thank you very much, gentlemen. We appreciate your testimony.

[By prior consent, Mr. Anthony submitted the following statement:]

SUMMARY STATEMENT OF REPRESENTATIVE BERYL ANTHONY ON H.R. 2354

Mr. Chairman, Mr. Duncan and I introduced H.R. 2354 to update and clarify the tariff treatment of gasoline and other motor fuels. The legislation is designed to prevent over reliance on imports of these refined products, which are increasing at an alarming rate and are threatening the viability of the Nation's highly efficient petroleum refining industry. The legislation would make the following changes:

A new tariff category for motor fuel blending stock would be created and dutied at the same rate as finished gasoline. The International Trade Commission has recommended this change in order to eliminate the confusing and anomalous treatment of various blending components under current law.

To improve enforcement and ease administration for Customs, the current "chief use" test for classification as motor fuel would be replaced by an "actual use" test for motor fuel and motor fuel blending stock. This change in both motor fuel *and* blending stock was also recommended by the ITC. It is important to change both classifications to an actual use test to eliminate confusion and abuse issue, not just to require an actual use test on blending stocks.

The tariff for motor fuel and motor fuel blending stock would be established at an ad valorem rate of 10.8% to replace the current motor fuel rate of 1.25¢ per gallon. The rate of 10.8% reflects the implicit ad valorem rate of the current tariff when it was adopted in 1958, when the wholesale price of gasoline was only 11.5¢ per gallon. It is also within the range of rates applicable to imports of comparable petrochemical products and the range of rates applicable to petroleum product imports in major foreign consuming countries. This comparability is required to offset the diversion and distortion occurring today as a result of the tariff and non-tariff barriers of these other countries. The tariff would apply to the first 3 billion gallons of motor fuel and blendstocks annually, which is approximately 200,000 barrels per day. This was the level of gasoline imports in 1982. By 1983, virtually all of the uneconomic U.S. refineries had closed following decontrol. Imports started increasing rapidly in 1983 to more than double previous levels and are now averaging over 500,000 barrels per day. More U.S. refining capacity has closed, and the United States is no longer self-sufficient in refining capacity. The crude in the SPR and secure crude imports afford us little security in a crisis without the refineries to convert it into products.

Imports of gasoline and motor fuel blending stock in excess of an annual threshhold of 3 billion gallons would be subject to a higher tariff rate of 21.6%. The increased tariff would discourage further imports in order to prevent further displacement of U.S. refining capacity, which I believe is essential to the national security of this country.

Imports of petroleum naphtha for use as petrochemical or refining feedstocks would not be affected. These imports could continue to qualify for the 0.25¢ per gallon duty for petroleum naphtha.

Mr. Chairman, I think this is worthwhile and needed legislation if we are to maintain our present refining capacity here in the United States, and I hope the Subcommittee would vote favorably to report it out of Committee.

Mr. **Pease.** I am advised Harvey Fox from the U.S. Customs Service is present. I would like him to come forward, if he would.

We are now back on H.R. 2349. During previous testimony and discussion, an interesting question arose as to why the Customs Service wouldn't have ruled that the 5 percent duty rate on assemblies would apply when Congress, under Mexico, apparently in the original boxes, certainly not as assembled in any way, not attached to any other components, and so on. Could you shed any background for us on this, why the Customs Service made this ruling?

STATEMENT OF RUSSELL ARNOLD, CHIEF, VALUE AND SPECIAL CLASSIFICATION BRANCH, U.S. CUSTOMS SERVICE

Mr. **Arnold.** I am Russell Arnold and I represent Mr. Fox. He could not attend.

It is a general customs practice that where you have articles that make up one entity, they are classifiable as an entirety, and when they have this TV circuit board and other parts and bring it in in the same shipment as the TV tube they are all considered as one. That has been the subject of many court decisions which we follow even though the parts are packaged separately. In fact, there have been cases where bicycle parts come in on the same boat but are in different parts of the boat. The court held that all parts are treated as a single bicycle. So there is ample precedent for that theory.

Mr. **Pease.** That is very interesting.

Mr. **Arnold.** I think it's to simplify administration because otherwise he would have to pick it apart and have a different rate for each part.

Mr. **Pease.** Well now, let me ask you a question. In the case of MIC Co., they apparently ship picture tubes from Japan to Mexico and then get some other parts and put them in a truck and bring them in at the 5-percent rate.

Mr. **Arnold.** They bring in enough to make it an unfinished television set, which is classifiable the same as a finished television set and the tube is included in there as part of a single entity.

Mr. **Pease.** I am wondering why they go through Mexico.

Mr. **Arnold.** I think they make part of the TV in Mexico other than the tube.

Mr. **Pease**. If they were to do the same thing and bring it indirectly from Japan through the port of San Francisco with the tubes in one box and the other parts in——

Mr. **Arnold**. It would be the same, the same rate.

Mr. **Pease**. It would be subject to the 5 percent rate?

Mr. **Arnold**. Yes.

Mr. **Pease**. Thank you very much. I appreciate that clarification. I have to leave for another engagement. Mr. Gibbons is on his way back, so I will declare a recess for a few minutes until Mr. Gibbons arrives and then we will continue with the hearing and we will proceed with witnesses on H.R. 2913. The subcommittee will be in recess.

[Pause.]

Chairman **Gibbons**. We will resume on H.R. 2913, Mr. Quillen's bill: Mr. English, manager, Washington operations, Stewart-Warner Corp.; Mr. Demouth, vice president, secretary and general counsel; Mr. Gold, vice president of the Allegheny International Exercise Co.

Go ahead.

STATEMENT OF JOSEPH J. ENGLISH, MANAGER, WASHINGTON OPERATIONS, STEWART-WARNER CORP., ACCOMPANIED BY TERENCE P. STEWART, COUNSEL

Mr. **English**. My name is Joseph J. English, the manager of Washington operations for Stewart-Warner Corp. I was originally expecting to be joined by Robin Demouth, vice president, secretary and general counsel; he has to stay in Chicago because of pressing business matters and——

Chairman **Gibbons**. We understand. Go right ahead.

Mr. **English**. Stewart-Warner wishes to express its strong support of H.R. 2913 to correct an enormous loophole in the tariff treatment of bicycle speedometers. Under present customs administration, essentially identical merchandise is treated differently for customs purposes.

There have always been a number of speedometer heads and a number of speedometer drive mechanisms available from United States and from foreign producers to satisfy the same function—the measurement of speed and distance. Speedometers that are used on physical fitness equipment are, and always have been identical to those used as accessories on bicycles. The speedometers for these two markets are produced from the same component parts, by the same workers, on the same assembly lines in the same plants. All speedometer heads and drive mechanisms have always been offered to all bicycle-type speedometer users.

These bicycle-type speedometers are, and always have been, significantly different in construction and price from the heavy-duty speedometers built to withstand the vibration and stress accompanying motorized vehicles—cars, trucks, buses, motorcycles, boats or airplanes. Prices for these heavy-duty speedometers run 10 times or more those for light-weight construction, bicycle-type speedometers. The units are produced by different workers, on different lines and in different plants.

The U.S. tariff treatment of speedometers has reflected this basic difference in product. This was true under the Tariff Act of 1930, as interpreted by court decisions and became the basis for the 1963 tariff schedule distinction—a distinction which was specifically carried over in the technical amendments made in 1965 and, until 1980, recognized and acted upon by the U.S. Customs Service. However, in 1980, Customs abruptly modified its position as to the classification of bicycle-type speedometers where chief use was alleged to be on exercise bicycles. Thus, since 1981 the double-gear speedometer, used on both exercisers and bicycles has been classified not with bicycle-type speedometers, but in the "Other" speedometer category, the category for heavy-duty speedometers used on motorized equipment.

By simply adding a nonfunctional 11-cent plastic "idler" gear, foreign speedometer manufacturers can reduce the duties for this product from 18.3 percent ad valorem to 0.6 percent ad valorem, a savings of many times the additional cost of the extra plastic gear. The reduced landed cost price of these foreign speedometers greatly undercuts Stewart-Warner's prices, resulting in sales declines to Stewart-Warner of over 30 percent during the last 2 years. Longstanding Stewart-Warner customers, in both the bicycle and exerciser markets, have since shifted purchasing offshore to take advantage of the reduced duty rates available for speedometers with the double-gear drive.

H.R. 2913 seeks a technical change to the tariff schedules to eliminate the unrealistic distinction presently found in customs administration. The bill does not change the existing tariff rate for other speedometers used on nonmotorized vehicles, but it will close the loophole created by Customs and not intended by Congress over the past 50 years.

[The prepared statements of Mr. English and Mr. Demouth follow:]

SUMMARY OF STATEMENT
BY JOSEPH J. ENGLISH,
MANAGER OF STEWART-WARNER CORPORATION'S
WASHINGTON OPERATIONS
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON TRADE, FEBRUARY 6, 1986
IN SUPPORT OF H.R. 2913

Stewart-Warner Corporation wishes to express its strong support of H.R. 2913 to correct an enormous loophole in the tariff treatment of bicycle speedometers. Under present customs administration essentially identical merchandise is treated differently for customs purposes.

There have always been a number of speedometer heads and a number of speedometer drive mechanisms available from U.S. and from foreign producers to satisfy the same function -- the measurement of speed and distance. Speedometers that are used on physical fitness equipment are, and always have been identical to those used as accessories on bicycles. The speedometers for these two markets are produced from the same component parts, by the same workers, on the same assembly lines in the same plants. All speedometer heads and drive mechanisms have always been offered to all bicycle-type speedometer users.

These bicycle-type speedometers are, and always have been, significantly different in construction and price from the heavy-duty speedometers built to withstand the vibration and stress accompanying motorized vehicles -- cars, trucks, buses, motorcycles, boats or airplanes. Prices for these heavy-duty speedometers run ten times or more than those for light-weight construction, bicycle-type speedometers. The units are produced by different workers, on different lines and in different plants.

The U.S. tariff treatment of speedometers has reflected this basic difference in product. This was true under the Tariff Act of 1930, as interpreted by court decisions and became the basis for the 1963 Tariff Schedule distinction -- a distinction which was specifically carried over in the technical amendments made in 1965 and, until 1980, recognized and acted upon by the U.S. Customs Service. However, in 1980, Customs abruptly modified its position as to the classification of bicycle-type speedometers where chief use was alleged to be on exercise bicycles. Thus, since 1981 the double-gear speedometer, used on both exercisers and bicycles has been classified not with bicycle-type speedometers, but in the "Other" speedometer category, the category for heavy-duty speedometers used on motorized equipment.

By simply adding a non-functional 11¢ plastic "idler" gear, foreign speedometer manufacturers can reduce the duties for this product from 18.3% ad valorem to 0.6% ad valorem, a savings of many times the additional cost of the extra plastic gear. The reduced landed cost price of these foreign speedometers greatly undercuts Stewart-Warner's prices, resulting in sales declines to Stewart-Warner of over 30% during the last two years. Long-standing Stewart-Warner customers, in both the bicycle and exerciser markets, have since shifted purchasing offshore to take advantage of the reduced duty rates available for speedometers with the double-gear drive.

H.R. 2913 seeks a technical change to the Tariff Schedules to eliminate the unrealistic distinction presently found in customs administration. The bill does not change the existing tariff rate for other speedometers used on non-motorized vehicles, but it will close the loophole created by Customs and not intended by Congress over the past fifty years.

As stated by Congressman Quillen upon his introduction of H.R. 2913, "[t]he bill merely confirms what historically has been true -- if a speedometer is built to the quality, durability and feature requirements of the recreational and physical fitness markets it will not be assessed the duty-rate designed for speedometers used on motorized vehicles." 131 Cong. Rec. E3066 (daily ed. June 27, 1985).

STATEMENT

My name is Joseph J. English, and I am the Manager of Stewart-Warner Corporation's Washington Operations. I am accompanied this morning by Robin Demouth, the Vice-President, Secretary and General Counsel for the Corporation, who will also testify.

On behalf of Stewart-Warner I would like to thank the Committee and its staff for giving me this opportunity to appear this morning. Stewart-Warner Corporation is a major domestic producer of bicycle speedometers for use as accessories on bicycles and for use as original equipment on exercise and training equipment.

I. Introduction and Overview

Stewart-Warner wishes to express its strong support for H.R. 2913, introduced by Congressman Quillen on June 27, 1985. H.R. 2913 is needed to solve an obvious problem with serious implications for U.S. producers of bicycle-type speedometers. The problem is treating essentially identical merchandise differently for customs purposes. The implications for U.S. producers are sharply increased price underselling capabilities by our foreign competitors with no change in their product or productivity, thus harming the domestic industry's ability to compete. The effects of the proposed change to the tariff schedules would not be detrimental to the American consumer. Rather H.R. 2913 would restore the conditions of competition to the pre-1980 status and would do so without subjecting the United States to retaliation by our trading partners. Stated differently, H.R. 2913 provides justice by eliminating an obvious problem with important consequences for an American industry. It is a problem only you, the members of Congress, can correct. H.R. 2913 is the vehicle for its correction.

Let me tell you more than you probably ever wanted to know about speedometers. Speedometers that are used on physical fitness equipment are, and always have been, identical to those used as accessories on bicycles. In fact, the speedometers for these two markets are produced from the same component parts, by the same workers, on the same assembly lines in the same plants. As the major physical fitness equipment using speedometers historically has been exercise-bicycles ("exercisers"), the identity of product with that used on regular bicycles should not be surprising.

There have always been a number of speedometer heads and a number of speedometer drive mechanisms available from U.S. and from foreign producers to satisfy the same basic function -- the measurement of speed and distance. All speedometer heads and drive mechanisms have always been offered to all bicycle-type speedometer users. That was true in 1930, in 1965, in 1980 and today. Indeed, the bicycle-type speedometers that presently are not classified as bicycle speedometers include speedometer heads and cables that are identical to those sold as part of bicycle speedometer kits and include a drive mechanism which is offered by foreign producers and Stewart-Warner for use on bicycles as well as exercise equipment. The parts are taken from the same production runs and the same inventory pool.

These bicycle-type speedometers are, and always have been, significantly different in construction and price from the heavy-duty speedometers built to withstand the vibration and stress accompanying motorized vehicles -- cars, trucks, buses, motorcycles, boats or airplanes. Prices for these heavy-duty speedometers run ten times or more than those for light-weight construction, bicycle-type speedometers. The units are produced by different workers, on different lines and, at Stewart-Warner at least, in different plants.

The U.S. tariff treatment of speedometers has historically reflected this basic difference in product. This was true under the Tariff Act of 1930, as interpreted by court decisions and became the basis for the 1963 Tariff Schedule distinction -- a distinction which was specifically carried over in the technical amendments made in 1965 and, until 1980, recognized and acted upon by the U.S. Customs Service. (I have included, as Exhibit 1 to this statement, the legislative history of the provisions covering bicycle-type speedometers since 1930.)

In 1980, Customs abruptly modified its position as to the classification of bicycle-type speedometers where chief use was alleged to be on exercise bicycles. Stewart-Warner's challenge of that decision, while successful at the Court of International Trade, was denied by the Court of Appeals for the Federal Circuit at the end of 1984. The result of the appellate court's affirmance of the revision in Customs' interpretation has been swift and severe harm to Stewart-Warner. By ordering the identical bicycle speedometer head and cable and selecting the drive mechanism which includes a non-functional 11¢ idler gear, any importer of bicycle-type speedometers can reduce its duties from 18.3% ad valorem to 0.6% -- a savings of many times the additional cost of the idler gear. The reduced landed cost price of these foreign speedometers greatly undercuts Stewart-Warner's prices and has led to significant loss of volume to Stewart-Warner.

Moreover, the drastic reduction in customs duty has restored the major underpricing capability of our foreign competitors that a ten-year-old dumping order eliminated in 1982 when the administering authority finally enforced the law. In 1971 Stewart-Warner commenced an antidumping case on bicycle speedometers from Japan, by far the largest source of imported bicycle-type speedometers. Upon completion of the investigation, an antidumping duty order was issued in 1972.

In that investigation, the term "bicycle speedometer" was specifically defined by the then U.S. Tariff Commission to include speedometers used on bicycles and exercise equipment.

Despite Stewart-Warner's continuous efforts to discover if the dumping order was being enforced, it was not until the first so-called section 751 review under the Trade Agreements Act of 1979 -- completed in 1982, ten years after the entry of the antidumping duty order -- that Stewart-Warner was able to obtain any corrective action. In 1982 the administering authority found the major Japanese producers and exporters had dumped bicycle-type speedometers at margins ranging from 19 to 25% ad valorem. So, after more than ten years, dumping was finally redressed in the form of an assessment of antidumping duties.

While one agency was finally providing the protection from unfair trade practices long mandated by the Congress, another agency was making a decision that in effect constituted a unilateral tariff reduction, essentially negating the corrective effect of fair pricing required by the dumping order.

Mr. Chairman and Members of the Subcommittee, the above introduction and overview may provide you with some idea of the frustration we at Stewart-Warner have felt over the inability to obtain corrective action to our long-standing trade problems despite fifteen years of effort.

H.R. 2913 seeks a technical change to the Tariff

Schedules to eliminate the unrealistic distinction mandated by the appellate court's decision. The bill does not change the existing tariff rate for other speedometers used on non-motorized vehicles, but it will close the loophole created by Customs and not intended by Congress over the past fifty years. To quote Congressman Quillen's eloquent remarks upon the introduction of this bill, "[t]he bill merely confirms what historically has been true -- if a speedometer is built to the quality, durability and feature requirements of the recreational and physical fitness markets it will not be assessed the duty-rate designed for speedometers used on motorized vehicles." 131 Cong. Rec. E3066 (daily ed. June 27, 1985). It is a fair bill that corrects an obvious problem. We at Stewart-Warner strongly urge prompt passage of H.R. 2913.

What follows is a more detailed examination of the problem, the harm to Stewart-Warner and the minimal impact corrective action under H.R. 2913 could have on the U.S. consumer.

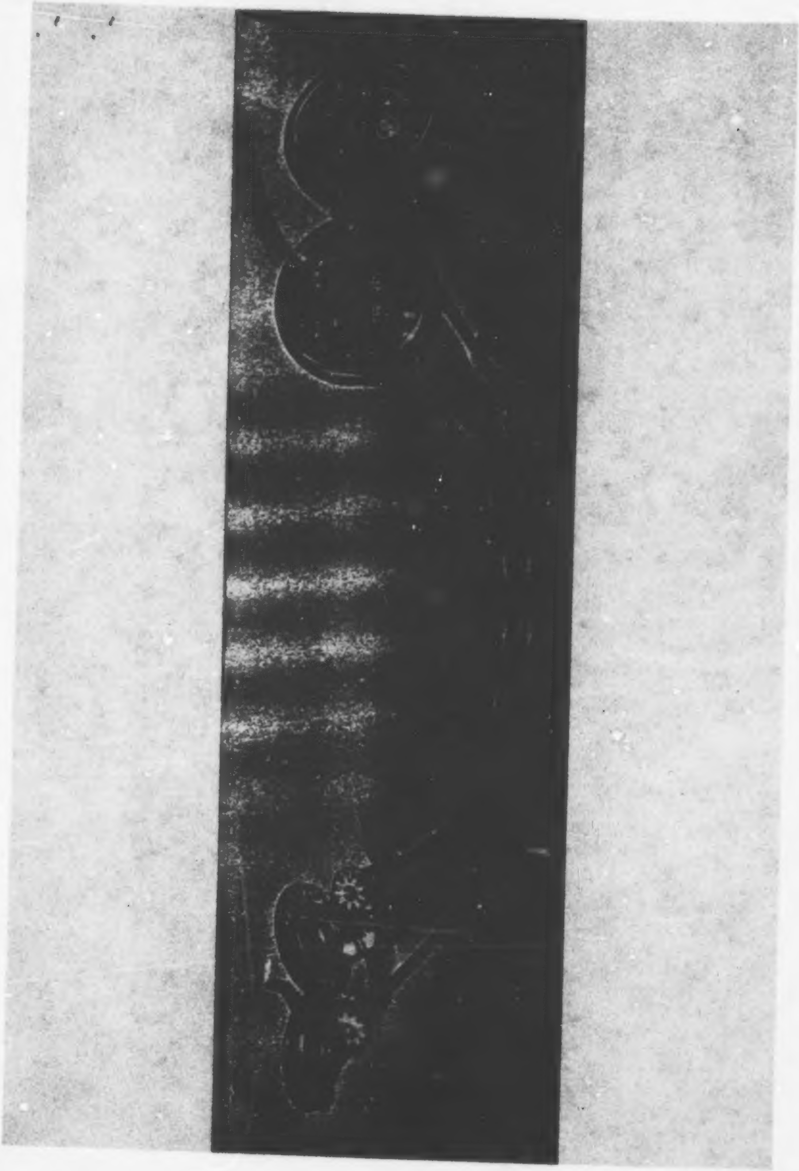
II. The Problem: Treating Essentially Identical Merchandise Differently for Customs Purposes

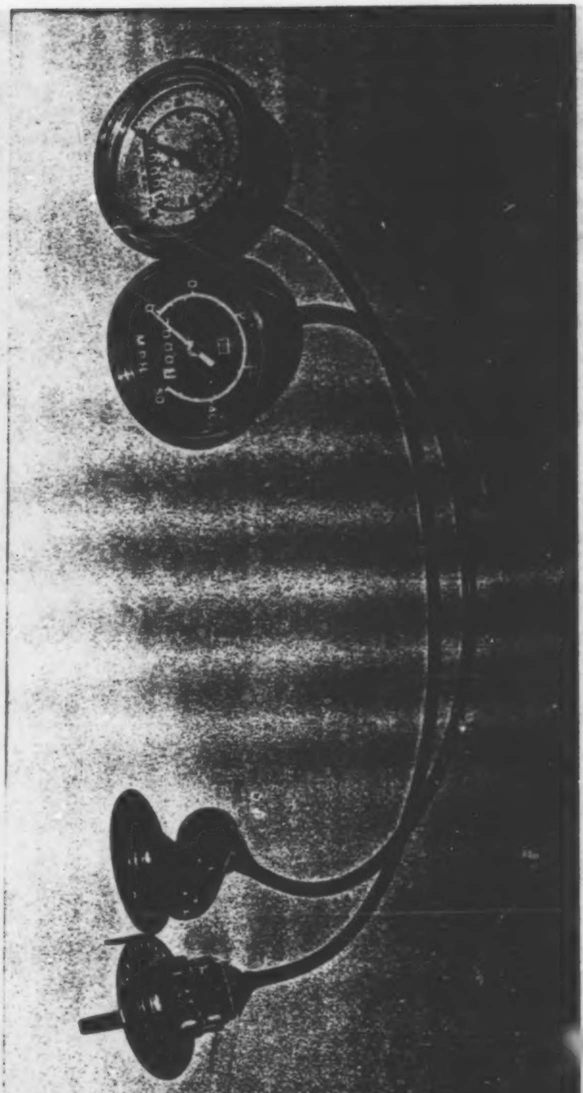
Drive mechanisms generally constitute the smallest part of the cost of a bicycle-type speedometer, with the speedometer head accounting for roughly 60% and the cable being the next most expensive part. There are now four main types of speedometer drive mechanisms manufactured for use on bicycles or exercise equipment: the single-gear, the double-gear, the enclosed-gear drive and the tire-drive. Since the 1980 Customs ruling, the double-gear speedometer is no longer classified as a "Bicycle speedometer" under item 711.93 but is classified as "Other speedometers" under item 711.98, subject to a 0.6% duty rate rather than the 18.3% duty rate applicable to the other types of bicycle speedometers even though the drive is offered for use on bicycles as well as exercise equipment and even though it is sold with speedometer heads and cables identical to those sold for use on bicycles.

Such a distinction is obviously illogical. Moreover, the double-gear and all other drive mechanisms are functionally identical. For example, the only external difference between the double- and single-gear drives is that the double-gear drive includes an additional "idler" gear, a plastic wheel whose sole function is to reverse the direction of the speed indicator needle on the speedometer head (clockwise to counterclockwise, or vice-versa).

Over the years, Stewart-Warner has produced all four types of drive mechanisms, offering all types to all end users. The same is true for any speedometer head or any cable produced by Stewart-Warner. In Stewart-Warner's Chicago plant complex, the manufacturing and assembly processes are identical for both the single- and double-gear drives. Speedometer head components are manufactured on the same machine tools by the same Stewart-Warner employees in the same department of the company, stored in the same inventory area, flow through the same assembly line, are assembled on the same assembly equipment, and are tested with and calibrated on the same testing equipment by the same quality control personnel regardless whether the ultimate destination of the product is an exercise equipment manufacturer or a bicycle-parts distributor. The cables are produced using the same core material, the same plastic outershell and the same tips and are assembled by the same workers greasing the cores and inserting the cores into the plastic casing. Finally, the drive mechanisms are produced by the same operators, using the same die cast, punchmolds and other equipment, and are stored in the same inventory number regardless of ultimate use as a bicycle accessory or as part of exercise equipment.

The identity between bicycle-type speedometers using the double-gear drive mechanism and other bicycle-type speedometers in use, function and manufacture is reinforced by the identity in appearance. The old adage, a picture is worth a thousand words is appropriate here. On the following pages, pictures of bicycle speedometers which use the double-gear drive are shown next to speedometers using the single-gear drive. The first picture compares a bicycle speedometer with a single-gear drive mechanism from Japan with a double-gear drive mechanism from Taiwan. On the following page, two Stewart-Warner bicycle speedometers are shown, one with a single-gear drive and the other with a double-gear drive. The virtual identity of the product is self evident.

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III. The Commercial Meaning of "Bicycle Speedometers" and the Construction, Design and Price of the Double-Gear Speedometer Indicate that Present Classification under TSUS 711.98 Is Illogical.

Historically, bicycle speedometers always have been used on exercise machines, without modification. Similarly, the newer double-gear models are also used interchangeably, without modification on either bicycles or exercisers. In fact, all of the bicycle speedometers manufactured to the present day, whether manufactured by Stewart-Warner or a foreign manufacturer, have always been offered for use on both bicycles and exercise equipment. Thus, in terms of actual commercial usage, the present distinction between bicycle and exerciser speedometers is unsupported.

Stewart-Warner patented and commenced production of bicycle speedometers over fifty years ago. From the earliest stages of production the bicycle speedometers were sold, without modification, for use as accessories on bicycles as well as for use on various exercise equipment, primarily stationary exercise bicycles. For example, Stewart-Warner ran a series of advertisements in 1935-1936 in magazines such as Boys' Life offering its speedometers for bicycles and for use on "home exercisers". The copy of one portion of an ad reads "STEWART-WARNER Bike Speedometer 'Professional' Model $4.95. A larger model for training purposes and home exerciser use. Records both speed and mileage." The same $4.95 speedometer was also sold for use on bicycles, as another 1936 ad makes evident.

Many bicycle manufacturers also manufacture exercisers, and have done so for many years. Exercise equipment manufacturers have been very large customers for Stewart-Warner bicycle speedometers for more than fifty years. This has been true of every drive mechanism, speedometer head or cable combination manufactured by Stewart-Warner or imported from overseas. All models can be used on bicycles without modification, including models using the double-gear drive. Both Stewart-Warner and foreign producers have offered all models to all users. For example, the Japanese have advertised a bicycle-type speedometer with the double-gear drive as a bicycle speedometer in a cycling magazine in the past, while Taiwanese producers have approached U.S. purchasers (including Stewart-Warner) to provide bicycle speedometers with any drive mechanism desired, including the double-gear.

For more than fifty years, the consistent commercial practice has been to refer to all such similarly constructed and used speedometers as "bicycle" speedometers, regardless of drive mechanism. Classification of the double-gear speedometer in the "Other" category ignores commercial reality. Ignoring the Bard's line that "a rose by any other name would smell as sweet", present classification of the bicycle-type speedometer with double gear drive as "other" than a "bicycle speedometer" truly makes "much ado about nothing".

Not only does common commercial usage dictate classification under item 711.93, but it is also absurd to classify the double-gear speedometer in the motorized vehicle speedometer category. A bicycle speedometer is built of relatively inexpensive materials and is intended to have a relatively short lifetime, approximately 10,000 miles, compared to automobile speedometers, with an approximate lifetime of at least 100,000 miles. Due to this factor and other factors such as vibration, speedometers used for motorized vehicles are significantly more expensive to produce and are far heavier and bulkier than the lightweight construction designed for non-motorized uses such as bicycles, mopeds and exercise equipment. Specifically, the heavy-duty speedometer requires a significantly larger magnet to supply enough force to rotate the pointer, a heavier hair spring to prevent the pointer from oscillating under heavy vibration, a silicon damping system to reduce vibration impact, an oil impregnated bearing to improve the life of the speedometer and stronger adhesives and fasteners. It is not surprising that the price differential between a motor vehicle and bicycle-type speedometer can be by a multiple of as much as ten or more.

Obviously, in terms of commercial usage, method of manufacture and value, the logical classification of the double-gear drive mechanism is with that of the other bicycle-type speedometers, 711.93. Thus, H.R. 2913 would reform the tariff schedule to reflect both commercial usage and common sense.

IV. The Implications: The 1980 Customs Ruling Has Had a Negative Impact on Stewart-Warner Sales, Production and Employment.

Due to the great disparity in tariff rates, U.S. importers have shifted purchases to bicycle-type speedometers with the double-gear drive since the appellate court's decision affirming the reversal in Customs' practice. Bicycle speedometers range in price from approximately $3.00 - $8.00 at the wholesale/manufacturer level. Yet the addition of the idler-gear, which increases the wholesale price no more than 11¢ per unit brings about a dramatic decrease in the tariff paid by importers. At 1986 rates, a bicycle speedometer is subject to an 18.3% rate resulting in a duty ranging from $0.55 to $1.46 per unit, depending on the price of the model. However, when the double-gear mechanism is used, the speedometer is subject to the 0.6% rate — a duty ranging from $0.02 to $0.05 per unit. This represents a savings of 17.6% of the total value of the speedometer.

Bicycles and exercise equipment are generally sold through the same channels of distribution, with manufacturers of bicycles often also producing exercisers. The consumer does not know or understand that there is any difference between the functionally identical bicycle-type speedometers. Since the sole effect of the additional gear in the double-gear model is to reverse the direction in which the needle in the speedometer head moves to indicate speed, product-shifting by some purchasers to reduce costs was immediate and dramatic.

A table of the import statistics compiled by the Census Bureau has been attached as Exhibit 2 to this statement. Virtually all imports from Taiwan in 1985 are now under 711.98, which confirms Stewart-Warner's own market information that the double-gear has become the primary drive mechanism exported from Taiwan since the appellate court decision. Similarly, while a significant volume of bicycle-type speedometers from Japan was already recorded under 711.98 by 1981 based on the customs ruling, that trend has accelerated in 1985 following the appellate court decision.

The immediate victim of the Customs change of position has been Stewart-Warner's bicycle speedometer business. Stewart-Warner's sales of bicycle speedometers have declined sharply in the last two years (approximately thirty percent) as major customers of long-standing duration have shifted purchasing offshore to take advantage of the reduced duty rate available for bicycle speedometers with the double-gear drive. The losses have occurred in both the bicycle and the exerciser markets. Importantly, these declines have taken place despite the generally favorable economic conditions in the United States during 1984 and 1985 and despite an expansion in bicycle and exerciser sales due to increased consumer spending and increased consumer awareness and participation in fitness and recreation.

For example, one of Stewart-Warner's largest customers, who for years purchased virtually all of its bicycle speedometers from Stewart-Warner (true as recently as early 1983), has shifted all of its purchases offshore into double-gear drive speedometers. The savings to the purchaser made possible by the duty reduction were too great to permit Stewart-Warner to remain competitive. In early 1983, this customer displayed nine models of exercisers at the National Sporting Goods Association Show, eight of which had speedometers with single-gear mechanisms and only one which had a double-gear speedometer. All or virtually all of those units were Stewart-Warner supplied. In 1984, none of this company's exercise equipment had single-gear speedometers and none of the business had been supplied by the domestic industry.

Coincident with the drop in volume at Stewart-Warner was a sharp drop in the average number of employees working on Stewart-Warner's bicycle speedometers in 1984 and 1985 (nearly forty percent in some departments). These adverse consequences to our workforce occur in Chicago, an area of relatively high unemployment, well over the national average. Of course, any reduction in Stewart-Warner's production levels has a ripple effect as Stewart-Warner's purchases of material and components from other companies fall, having a similarly predictable deleterious impact upon those companies and their employees. The impact on the Company and its employees from the Customs change in practice has been real and immediate.

V. The Effects of H.R. 2913: Applying the Higher Rate of Duty to Double-Gear Bicycle Speedometers Would Restore Conditions of Trade for the Domestic Industry Without Greatly Affecting the Consumer.

Classification of double-gear speedometers as "Bicycle speedometers" under TSUS No. 711.93 (as proposed, new 711.92) would result in an increase of duty for those speedometers from the present 0.6% to 18.3% *ad valorem*. Our analysis indicates that such an increase could have a significant effect upon the choice of speedometers purchased at the original equipment manufacturer and distributor level, but would have very little impact on the cost of the exerciser to the consumer. Prices of speedometers imported into the United States range from around $3.00 to $6.50 per unit (significantly higher for the relatively new digital units).

Under current law, double-gear speedometers are dutiable under TSUS No. 711.98 at a duty rate of 0.6%. Accordingly a duty of $0.02 is levied on the cheapest speedometers and $0.04 on the most expensive. Were these speedometers treated as bicycle speedometers under item 711.93, the duty would rise to $0.55 and $1.19 respectively. This constitutes an increased cost to the buyer of the imported speedometers. Although not great in absolute terms, due to the low price of bicycle speedometers, that duty increase represents an increased cost of about 18% to purchasers of imported double-gear speedometers. Such an increase in cost in a relatively price sensitive market would be a powerful incentive for domestic original equipment manufacturerss and distributors to again source their speedometer requirements domestically instead of sourcing overseas.

While an increase in duty could have an important impact on the speedometers used in exercisers, it would have very little impact on the cost of the exercisers themselves. The cost of the speedometer is a minor part of the cost of an exerciser as a whole. Our research shows that, while the prices of exercisers vary widely, a typical lower-end model will retail for about $125, and an upper-end model for $315 or more, with an average price around $200. Using an assumed retail markup of 40%, wholesale prices of between $75 and $190 are derived. Assuming that the cheapest model exerciser uses a less expensive speedometer, the increase in cost to the wholesaler brought about by an increase in duty would be as little as 0.73%. Similarly, application of the higher duty should not cause a price rise greater than 0.63% for the most expensive exerciser models using the most expensive speedometer. Even should the wholesaler and the retailer pass the full increase in cost on to the consumer, along with a mark-up for their profit, the increase in retail price caused by the increase in duty is obviously minimal. Thus, passage of H.R. 2913, by amending TSUS No. 711.93 to read "Bicycle-type speedometers" will result in the immediate reinstatement of the tariff protection envisioned by Congress in 1965 for bicycle-type speedometers without affecting the price of the product to the consumer.

VI. Conclusion

At a time when our nation is running a trade deficit of $150 billion/year, when our country has become a debtor nation, when foreign countries through non-tariff barriers effectively keep American products shut out of foreign markets, when the dollar (although down from recent highs) remains overvalued, placing enormous strains on U.S. industries and their workers, the U.S. Customs Service and our federal courts have granted a unilateral trade concession which threatens the survival of the U.S. industry producing bicycle-type speedometers. Such a path is folly for the nation and most certainly destructive for our industry. This unilateral trade concession, in the form of the 711.98 loophole for double-gear speedometers, threatens to swallow the tariff provision intended to afford some protection to the domestic industry. It is ironic that in 1980 and 1984 our government opened a destructive loophole to a provision that Congress, in modifying the Tariff Schedules in 1965, had established in order to close a loophole to effective tariff enforcement.

The effect on Stewart-Warner has been swift and severe. Sales have dropped sharply; entire accounts have shifted overseas in pursuit of the advantage of the court-provided loophole. We at Stewart-Warner do not believe that it was the intention of the House Ways and Means Committee or the Congress in 1964 and 1965 to so emasculate our tariff protection. We are not ready and not willing to be so sacrificed.

H.R. 2913 will close a pernicious loophole and will preserve our industry. The bill is consistent with past tariff assessment and reflective of business realities. It clarifies that which has been intended and, until 1980, practiced all along. On behalf of Stewart-Warner's employees, its management, its shareholders, its consumers and in the interests of our suppliers, I request the Subcommittee on Trade and the full Committee on Ways and Means to promptly report out H.R. 2913 and work for its early passage.

EXHIBIT 1

Historic Tariff Classification of Bicycle-Type Speedometers

1. The bicycle speedometer was first patented by Stewart-Warner more than 50 years ago. Since its introduction, Stewart-Warner has sold its bicycle speedometers for use on bicycles and as original equipment on training bicycles and exercise equipment. Under the Tariff Act of 1930, bicycle speedometers were classified under ¶ 368(a), a single provision which included all devices for measuring speed, time and distance. The nominal rate of duty was $2.25 per unit plus 35% *ad valorem*.

2. In *Industrial Operations v. United States*, 30 Cust. Ct. 82 (1953), the Customs Court determined that speedometers used on motorized vehicles were properly classifiable as vehicle parts under ¶ 369(c).

3. Bicycle speedometers on the other hand were specifically found to be included under ¶ 368(a). *VDO Instruments v. United States*, 45 Cust. Ct. 77, C.D. 2200 (1960).

3. Pursuant to Title I of the Customs Simplification Act of 1954, as amended, the U.S. Tariff Commission made a comprehensive study of the United States laws prescribing the tariff status of imported articles for the purpose of recommending to the President and Congress revisions and consolidations which would result in more logical, simplified and less anomalous classifications.

4. The Tariff Commission's proposed tariff schedule maintained the two speedometer categories pursuant to the Customs Court decisions in *Industrial Operations* and *VDO Instruments*. Specifically, the Commission recommended classification under two provisions, item 711.92 for "Speedometers suitable for use in highway type motor vehicles" (9% *ad valorem*) and item 711.94, "Other speedometers and tachometers" ($2.25 each and 35% *ad valorem*). These recommendations were adopted as proposed in the Tariff Classification Act of 1962, Pub. L. No. 87-456, 76 Stat. 72 *et seq*. (1962).

5. The 1962 Act mandated a supplemental study to find and correct errors and omissions in the newly enacted tariff schedules. The House Committee on Ways and Means invited all interested parties or groups to submit written statements and briefs for suggested changes and revisions to the tariff schedule.

6. Stewart-Warner submitted a written statement to the Committee by letter dated July 27, 1964. In that submission, W.E. Faithorn, Jr., Assistant Secretary for Stewart-Warner, noted that bicycle

speedometers, normally subject to the higher duty rates, were reportedly being imported into the United States for use on light motorized vehicles such as mopeds and motorbikes under the low rate classification intended for heavier-duty speedometers used in automobiles and trucks. The letter stated, "it has come to our attention that speedometers manufactured for installation as original equipment on motor bicycles or light motorcycles known as mopeds and/or mobilettes, from the point of view of design, material construction, and overall quality, are built to the less expensive standards for a bicycle speedometer as compared to a regular motorcycle or an automobile instrument . . . ." Mr. Faithorn concluded that a clarification in the tariff schedule was necessary to close the obvious loophole and to insure that all lightweight construction speedometers would be covered by the higher tariff provision.

7. In drafting the technical amendments to the tariff schedules, the Committee shifted the focus of the speedometer provision by breaking out a specific item for bicycle speedometers (711.91, 55% *ad valorem*) (later changed to the present 711.93) and classifying heavy-duty speedometers used on motorized vehicles in the "Other" category (711.98, 10% *ad valorem*). H.R. Rep. No. 1728, 88th Cong., 2d Sess. 25 (1964); *accord* S. Rep. No. 1601, 88th Cong., 2d Sess. 16 (1964). The legislative history of this provision confirms that the Committee made the changes to address Stewart-Warner's specific concerns. The report stated "[t]he new provision for bicycle speedometers would include certain bicycle-type speedometers which are used to a limited extent on motor scooters and motor bikes and which are currently classified under item 711.92 as being 'suitable for use in highway-type motor vehicles.'" H.R. Rep. No. 342, 89th Cong., 1st Sess. at 26 (1965).

8. The primary distinction in the tariff classification turned on whether the speedometers were designed for highway-type motorized vehicles or were of lightweight construction for bicycle-type use. This distinction was recognized by the Customs Service and was the uniform practice until the 1980 Ruling. A line of uncontradicted rulings held that "a speedometer-odometer used on a stationary bicycle exerciser and which could be used without alteration as a speedometer on regular bicycles was classifiable under item 711.93, TSUS, as a bicycle speedometer." Ruling of June 2, 1977 (C.I.E. N-36-75, on Internal Advice Request No. 13-77); *accord* Ruling of May 24, 1967 (SP426.845F); Ruling of February 10, 1967 (C.I.E. 179.67).

9. During this period before the 1980 Ruling, Stewart-Warner filed an antidumping duty petition against bicycle speedometer imports from Japan. Stewart-Warner intended this petition to cover all bicycle speedometers regardless of their final end use. The Tariff Commission, in *Bicycle Speedometers from Japan*, Inv. 1921AA-98 (June 1972), determined that the dumped speedometers were injuring the domestic industry. In making that determination, the ITC

questionnaire sent out to domestic producers defined the term "bicycle speedometers" as "[a]n instrument attached to a bicycle or exercise machine . . . ." Tariff Commission Producer Questionnaire at 2, Bicycle Speedometers from Japan, supra (emphasis added).

10. The International Trade Administration in its administrative reviews of the outstanding antidumping order have necessarily considered speedometers used on exercisers, including the double-gear hub drive, to be within the scope of the bicycle speedometer antidumping duty order. Bicycle Speedometers from Japan, 47 Fed. Reg. 28,978 (1982); 49 Fed. Reg. 15,247 (1984).

11. In 1979, Stewart-Warner filed an "American Manufacturer's Protest", 19 U.S.C. § 1516, to determine the correct classification of speedometers used on exercise equipment. Upon denial of that protest, the company appealed to the Court of International Trade. The Court of International Trade agreed with the Stewart-Warner position that exerciser speedometers were correctly classified as bicycle speedometers. Relying on the legislative history of the 1965 tariff amendments, the court rejected the 1980 ruling and stated:

> Indeed, the House Report, when read in the context of the Faithorn letter makes it plain that it was the intent of Congress to prevent bicycle-type speedometers, which could readily be used in bicycles, from being imported at tariff rates lower than the rates which applied to bicycle speedometers.

Stewart-Warner Corp. v. United States, 6 CIT ___, 577 F. Supp. 25, 27 (1983) (emphasis in original).

12. The Justice Department appealed the decision and the Court of Appeals for the Federal Circuit reversed the lower court finding by narrowly interpreting the legislative history of the 1965 Act so as not to include bicycle-type speedometers in the provision. The court then construed the tariff provision in question to be a "use" provision, limiting the TSUS No.'s coverage only to speedometers actually used on bicycles. The court then reasoned that since the primary "use" of bicycle-type speedometers with a double-gear drive mechanism was not on "bicycles", item 711.98 was the correct classification provision.

EXHIBIT 2

SPEEDOMETER IMPORTS FROM JAPAN AND TAIWAN
TSUS 711.93 and TSUS 711.98
($000's)

	TAIWAN		JAPAN	
Year	711.93	711.98	711.93	711.98
1981	$247	$1,100	$1,797	$13,700
1982	$92	$1,939	$1,229	$11,700
1983	$37	$3,200	$1,200	$14,816
1984	$629	$3,380	$3,163	$23,553
1985 (Jan.-Nov.)	$176	$3,520	$2,051	$21,897

SUMMARY OF STATEMENT BY ROBIN M. DEMOUTH, VICE-PRESIDENT, SECRETARY AND GENERAL COUNSEL, STEWART-WARNER CORPORATION BEFORE THE HOUSE WAYS AND MEANS COMMITTEE SUBCOMMITTEE ON TRADE, FEBRUARY 6, 1986 IN SUPPORT OF H.R. 2913

Although passage of H.R. 2913 would result in an increase in duty levied on double-gear speedometers used on bicycles and exercisers, passage of the bill would not be violative of any international obligations of the United States, including the tariff bindings negotiated by our trade representatives in GATT tariff reduction agreements.

The bill does not raise the duty rates for either "Bicycle speedometers" (under item 711.93) or "Other speedometers" (under item 711.98). Those rates will remain within the levels negotiated with our trading partners during the Tokyo round negotiations.

Passage of H.R. 2913 would merely restore United States tariff treatment on all bicycle-type speedometers to that in existence at the time of the tariff reduction negotiations. Those negotiations were held between 1974 and 1979. At that time, well before the 1980 Customs ruling, item 711.93 was understood under United States law and Customs administration to include any speedometer that could be mounted on a bicycle without modification. The 1980 Customs Ruling that placed the double-gear model in the 711.98 classification occurred well after the completion and ratification of the Tokyo round negotiations.

The only possible classification for exerciser speedometers during the period of the Tokyo Round negotiations was item 711.93 TSUS. The legislative history of the last tariff change expressly provied the the "Bicycle speedometer" classification, 711.93, encompassed "bicycle-type" speedometers capable of use on lightweight motorbikes and motor scooters. The "Other speedometer" classification, 711.98, was to include speedometers used on motorized vehicles (previously 711.92). Customs Service rulings held even as late as 1977, during the period of the GATT tariff reduction negotiations, that a speedometer-odometer used on a stationary bicycle exerciser and which could be used without alteration as a speedometer on regular bicycles was classifiable under item 711.93, TSUS, as a bicycle speedometer.

Commercial usage also indicates that classification under 711.98 was proper. Since the 1930's, all speedometers sold for use on bicycles have been offered for sale on exercise equipment. All bicycle-type speedometers, regardless of use have been known as "bicycle speedometers".

It is further apparent that the actual United States negotiators to the Tokyo round fully understood that TSUS item 711.93 encompassed speedometers used on bicycles and exercisers. In 1977, the Office of the Special Trade Representative held hearings concerning the tariff negotiations. Stewart-Warner participated in those hearings and was the only party to submit comments on TSUS item 711.93. In its submission, Stewart-Warner described the market of its completed bicycle speedometers as sales to "bicycle manufacturers, and to wholesalers, for sale as an accessory for bicycles, and to 'exerciser' manufacturers as original equipment for installation in exercisers." Stewart-Warner had requested that tariff reductions be lower than the 60% across the board level contemplated by our trade negotiators and Stewart-Warner had included an identification of five important customers (including two exerciser manufacturers) to whom Stewart-Warner had lost significant sales to foreign bicycle speedometers. Duty rates were reduced less than 40% as a result of the hearings.

Passage of H.R. 2913 is thus consistent with U.S. international obligations.

STATEMENT

Good morning, Mr. Chairman and Members of the Subcommittee. I am Robin M. Demouth, Vice-President, Secretary and General Counsel of the Stewart-Warner Corporation. My statement today addresses a single issue: will passage of H.R. 2913 be violative of any international obligations of the United States? As with any tariff bill that calls for an increase in current tariff-duty rates, this Subcommittee has an interest in knowing whether such increase could be viewed as constituting a violation of a tariff binding negotiated by our trade representatives under the auspices of GATT.

The answer for bicycle-type speedometers not presently classified under 711.93 is easy -- no violation of GATT would occur through passage of H.R. 2913.

Although classification of double-gear speedometers as "Bicycle speedometers" under TSUS No. 711.93 would result in an increase of duty for those speedometers from the present 0.6% to 18.3% ad valorem, this bill does not increase the duty rates for either "Bicycle speedometers" (TSUS item 711.93) as that term was understood at the time of the tariff negotiations or "Other speedometers" (TSUS item 711.98). The rates will remain within the levels negotiated with our trading partners at the Tokyo round negotiations. Thus, upon passage of this bill, the tariff rate in 1987 on bicycle speedometers, including the double-gear mechanism (711.93), will still be reduced to 17.0%, pursuant to international agreement. Also pursuant to the agreement, in 1987 the duty rate on "Other speedometers" will be reduced to 0.0%. The bill does not attempt to reestablish duty rates to levels higher than those agreed to in our negotiations with our trading partners. The bill's only effect will be to reclassify an item within the duty limits of our agreement commitments.

But such reclassification is not inconsistent with the understanding of "bicycle speedometers" at the time of the Tokyo round of tariff negotiations. Indeed, H.R. 2913 merely restores the U.S. tariff provisions to conformity with the tariff schedules as negotiated. At the time of the GATT tariff reduction negotiations, 1974-1979, item 711.93, "Bicycle speedometers," was understood, under United States law and customs administration, to be any speedometer that could be mounted on a bicycle without modification. It was only after the 1980 Customs Ruling (well after the conclusion of the GATT negotiations) that the Customs Service determined that one particular bicycle-type speedometer (admittedly capable of use without modification on a bicycle) was classified under 711.98 and not 711.93. Passage of the bill would therefore restore the classification to the status it had during the negotiation period and would harmonize U.S. tariff provisions with the negotiated levels.

As reviewed in Exhibit 1 to Mr. English's statement, the only possible classification for exerciser speedometers during the period of negotiations, 1974-1979, was item 711.93 TSUS. The legislative history of the last tariff change expressly provided that the "Bicycle speedometer" classification, 711.93, encompassed "bicycle-type" speedometers capable of use on lightweight motorbikes and motor scooters (and hence arguably classifiable under 711.92 (suitable for use in highway type motor vehicles) as enacted in 1963) -- an effort by the Congress to specifically prevent any loophole in the classification of light-weight construction speedometers.

The "Other speedometer" classification, 711.98, was to include speedometers used on motorized vehicles. The two provisions (711.93 and 711.98) thus maintained the distinction in classification that had existed for fifty years. This distinction is clear from the court decisions interpreting the Tariff Act of 1930 provisions, from the 1963 Tariff Schedules (divided into speedometers capable of use on on-the-highway vehicles and other speedometers) and from the modification to the 1963 classifications in response to Stewart-Warner's concern of diversion of bicycle-type speedometers into a lower duty category. Since 1930, all speedometers sold for use on bicycles have been offered for sale as well on exercise equipment. All bicycle-type speedometers, regardless of use, have been known as "bicycle speedometers". Finally, there was no question that a speedometer used on an exercise machine was used on an on-the-highway motorized vehicle. From 1930 until 1980, all bicycle-type speedometers (regardless of use) have been assessed the higher duty rate of the two competing provisions.

Not only is the legislative history conclusive as to the proper classification during that period, but Customs Service rulings also concluded, even as late as 1977, during the period of the GATT tariff reduction negotiations, that a speedometer-odometer used on a stationary bicycle exerciser and which could be used without alteration as a speedometer on regular bicycles was classifiable under item 711.93, TSUS, as a bicycle speedometer. Ruling of June 2, 1977 [C.I.E. N-36,75, on Internal Advice Request No. 13-77]; accord Ruling of May 24, 1967 [SP426.845F]; Ruling of February 10, 1967 [C.I.E. 179.67]. Moreover, as explained by Mr. English and detailed in Exhibit 1, during the antidumping investigation of bicycle speedometers from Japan, the ITC in 1972 defined "bicycle speedometer" as including all speedometers used on bicycles or exercise equipment. Indeed, much of the information presented on lost sales and price depression by Stewart-Warner pertained to bicycle speedometers sold to exercise manufacturers.

It is further apparent that the actual United States negotiators to the Tokyo round fully understood that TSUS item

711.93 encompassed speedometers used on bicycles and exercisers. In 1977, the Office of the Special Trade Representative held hearings concerning the tariff negotiations. Stewart-Warner participated in those hearings and was the only party to submit comments on TSUS item 711.93. In its written statement Stewart-Warner presented views on why tariff rate reduction on bicycle speedometers should not be reduced the full 60%, the proposed across-the-board rate of reduction. In that submission, Stewart-Warner described the market of its completed bicycle speedometers as sales to "bicycle manufacturers, and to wholesalers, for sale as an accessory for bicycles, and to 'exerciser' manufacturers as original equipment for installation in exercisers." See Exhibit 1, excerpts from Stewart-Warner Corporation submission to the Trade Policy Staff Committee, Office of the Special Representative for Trade Negotiations, September 1, 1977.

Moreover, in describing lost bicycle speedometer sales in 1977 to competing Japanese manufacturers, Stewart-Warner noted a loss of several hundred thousand units to large volume buyers due to lower priced Japanese and European bicycle speedometers. Of the five lost large volume buyers, two of these were exercise equipment manufacturers, accounting for over 36% of the noted lost units. Id. at 13-14. Apparently, Stewart-Warner's arguments were heeded as the tariff rate reduction for TSUS item 711.93 was limited to a 38% reduction, from 27.5% to 17.0% ad valorem.

To Stewart-Warner's knowledge and belief, there were no questions raised during the hearing process or in international negotiations (certainly Stewart-Warner was never advised of any questions raised) that Japan or any other of our trading partners perceived that bicycle speedometers excluded items chiefly used on exercise equipment. The 1980 Ruling therefore amounted to a unilateral concession not required or sought by our trading partners. Returning all bicycle-type speedometers to the classification existing during the GATT tariff reduction negotiations would not constitute a violation of those agreements.

Passage of H.R. 2913 would clarify that which was true for double-gear hub drive and all other bicycle-type speedometers prior to the 1980 ruling and which was true during the Tokyo round tariff reduction negotiations. The tariff rate requested for all bicycle-type speedometers is within the contemplated agreement concessions levels. The bill does not request a duty rate higher than the concession agreement levels, an event that would lead to possible GATT violations. Thus the bill would not subject the United States to retaliation or liability for compensation.

I join Joe English in requesting prompt favorable action by this Subcommittee on H.R. 2913.

EXHIBIT 1

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WASHINGTON, D. C. 20036

EUGENE L. STEWART
FREDERICK L. IKENSON

TELEPHONE
(202) 785-4185
TELEX 89-533

September 1, 1977

Exhibit "A".

EXCEPTIONS NOMINATION AND JUSTIFICATION

TSUS Item 711.93
Bicycle speedometers
and parts thereof

Submitted by: Stewart-Warner Corporation;
Alemite and Instrument Division
Eugene L. Stewart, Esq.
Special Counsel
202-785-4185

Product: bicycle speedometers, and parts thereof.

This article is manufactured by Stewart-Warner in its plant in Chicago. The component parts are fabricated there, and they are then assembled into the several models of bicycle speedometers, which are then sold directly to bicycle manufacturers, and to wholesalers, for sale as an accessory for bicycles, and to "exerciser" manufacturers as original equipment for installation in exercisers. Stewart-Warner is the sole domestic manufacturer. The manufacturing process is moderately capital intensive; but in view of the diversity of the component parts, which are mostly fabricated by Stewart-Warner, and the assembly procedures for uniting these parts into completed bicycle speedometers, the manufacturing process is also moderately labor intensive.

TSUS No.: 711.93

Tariff Rate: 27.5% ad valorem.

I. PRICE EFFECTS

For purposes of this section, we assume that were there to be a 60% reduction in the duty, the effective rates (after rounding) would be as follows:

Pre-MTN rate:	27.5%
1-1-79:	24.0%
1-1-80:	20.5%
1-1-81:	17.0%
1-1-82:	14.0%
1-1-83:	11.0%

VII. OTHER FACTORS AND TRENDS

BUSINESS CONFIDENTIAL:
SUBMITTED IN CONFIDENCE TO THE TRADE POLICY STAFF COMMITTEE.

This would force Stewart-Warner to cancel its anticipated price increase with further economic injury of the type shown by the above P & L data.

For the 1977 marketing year, Stewart-Warner lost a total of units of bicycle speedometer sales to major purchasers, as follows:

(a manufacturer of Exercisers): units, purchased from Japan;

(a manufacturer of Exercisers): units, purchased from Japan;

(a manufacturer of bicycles, which distributes bicycle speedometers through its national chain of outlets for sale as accessories): units, purchased from France;

(the leading distributor/wholesaler of bicycle speedometers): units, purchased from Japan;

(a leading national mass merchandiser): units, purchased from Japan.

Mr. **English**. Now if I might, I would like to request Mr. Terence Stewart, our special outside counsel, to address the points made by the administration in opposing H.R. 2913.

Chairman **Gibbons**. Go ahead.

Mr. **Stewart**. The administration essentially raised three points; including one modification. They would propose to permit staging in accordance with the Tokyo Round, a change which Stewart-Warner does not oppose.

The two objections appear to be: One, that the increase in duty rate on speedometers used on exercise equipment would pose a significant cost to exercise bicycle manufacturers which could put them in jeopardy; and two, Stewart-Warner is presently undersold by imports in amounts up to 60 percent, and so a change of 17.7 percent of the duty rate will not create a solution. Neither of those positions, we would submit, have any validity.

The prepared statement by Allegheny International's representative indicates on page 2 that the cost of speedometers represents approximately 10 percent of the cost of materials for exercisers. From your vast experience, Mr. Chairman, with a wide variety of industries, you know material costs almost never total an amount of 50 percent of total cost. But taking the 10 percent as being a reasonable figure, the increase in duty would represent an increase in material costs of 1.77 percent.

Now, even if material costs represented 50 percent of total cost, that is an increase in cost of manufacture of less than 1 percent, and we would ask you how realistic is it, in an industry that has quadrupled in a period of 4 or 5 years, to believe domestic manufacturers would be hurt by an increased cost of less than 1 percent.

With respect to the 60 percent below Stewart-Warner prices, we would state the following: There has been a dumping case and a dumping order in effect for more than 12 years. As a result of that dumping order and as a result of the annual review process, the public record contains a lot of information about the export prices of speedometers from the major foreign supplier, which is Japan. Those prices at today's exchange rates, using the 18.3 duty rate that would be available under the proposed 711.92, that which presently exists under 711.93, would provide, landed prices, duty paid, ignoring the 25 percent, 20 to 25 percent dumping duties that are currently being paid, that would be comparable to Stewart-Warner's prices. So there is no merit that the relief that Stewart-Warner seeks through the technical amendment that is proposed in H.R. 2913 would not in fact make a significant difference to the domestic producers.

In fact, the party appearing in opposition, Allegheny International, as recently as 2 to 3 years ago purchased virtually all of its speedometers from Stewart-Warner. The very reason it stopped purchasing from Stewart-Warner was the dramatic reduction in duty rates that were made available through the court decision that found an identical item with an additional piece of plastic constituted a different article and hence was entitled to a 17 or 18 percent duty savings.

Mr. Chairman, I think that exhausts our time. We strongly support H.R. 2913 and hope that the committee will report it out promptly.

Chairman GIBBONS. All right. Fine. We now are informed that the other people on your panel have just arrived and so we will hear from them.

STATEMENT OF NORMAN GOLD, VICE PRESIDENT, ALLEGHENY INTERNATIONAL EXERCISE CO., ACCOMPANIED BY RICHARD M. BELANGER, COUNSEL

Mr. GOLD. My name is Norman Gold and I am appearing in a capacity as vice president of Allegheny International Exercise Co., which is located at 321 Bypass North, P.O. Box 778, Lincolnton, NC, 28092. With me is Richard M. Belanger of the Washington, DC law firm of Sharretts, Paley, Carter & Blauvelt, P.C., counsel to the company. I speak in opposition to H.R. 2913, which would increase the duty on imported speedometers designed for and used exclusively on stationary exercise equipment from 1.3 percent to 19.6 percent. In the case of imports from designated countries under the generalized system of preferences [GSP], the duty would be increased to 19.6 percent from zero.

Allegheny International Exercise Co., a subsidiary of Allegheny International, Inc., manufactures exercise equipment, including among other items, stationary exercise bicycles under private labels as well as the trade name "Vitamaster". The manufacturing is done at our plant in Lincolnton, NC, where we employ approximately 500 individuals. The plant was a textile manufacturing facility that had been shut down several years ago. AI Exercise purchased the plant and invested significant capital in modernizing it and converting it for the manufacture of exercise equipment. This investment by AI Exercise in the local economy has created jobs in an area where they were sorely needed.

AI Exercise imports double gear hub speedometers for use in the manufacture at the North Carolina plant of the exercise bicycles. The speedometers represent approximately 10 percent of the costs of materials used for our exercisers. If approved, the proposed bill would increase the most-favored-nation duty on imported speedometers an astounding 1,500 percent, which in turn would naturally result in AI Exercise being required to increase the price of its exercise bicycles. As you might suspect, the industry is highly competitive and one in which even a slight increase in price would have a significant adverse consequence for the company. This is particularly so since competitors of AI Exercise may import entire finished bicycles, including speedometers, and pay a duty rate of only 5.5 percent on the completed product—zero if it is the product of a GSP-eligible country other than Taiwan. The obvious result of the proposed increased tariff would be to severely impact the ability of the domestic manufacturers like AI Exercise to compete with foreign goods. If this bill were to become law, our company would seriously have to consider importing finished exercisers, rather than continuing to manufacture here.

We also believe that making exercise equipment speedometers dutiable at the same high rate of duty applicable to bicycle speedometers makes little sense, because the two industries are completely separate and distinct. An exerciser is stationary, has only one wheel, and is used like a rowing machine in a health regimen, to improve the cardiovascular system and for other physical benefits. A bicycle, on the other hand, has two wheels and is a means of transportation.

All exercisers have speedometers. Double gear hub drive speedometers are incorporated as original equipment in the process of manufacturing an exerciser. Most bicycles do not have speedometers. Bicycle speedometers usually are accessories added by the bicycle owner. No major manufacturer of exercisers makes bicycles. These differences and the fact that speedometers designed for exercisers have never been used on bicycles have been recognized by the U.S. Customs Service and the appellate court in their rulings that exerciser speedometers are classifiable differently than bicycle speedometers.

Enactment of this bill would also expose the United States to compensatory claims and possible retaliation. The current most-favored-nation duty rate of 1.3 percent ad valorem is the rate resulting from the Tokyo Round of trade negotiations. As such, the rate is "bound" under the General Agreement on Tariffs and Trade. Any increase such as is proposed, without the formal findings required in any of the import relief proceedings established by law, would violate our GATT commitments. This country would be subject to a claim for compensation or to retaliation by affected countries.

If an industry in the United States is truly being injured by imports which are being properly classified, it should be required to follow the traditional methods under the Trade Act of 1974 of seeking import relief. The committee should not allow any industry to bypass those standards, for U.S. industries adversely affected by imports. Enactment of this bill would set a dangerous precedent by signaling other specialized segments of American industry that traditional trade relief measures need not be followed.

It is a fallacy to believe that the difficulties being experienced by a U.S. speedometer manufacturer, either as a result of competition or of inefficiencies in its manufacturing process, can be eliminated by raising the duty rate and thereby eliminating its competition. The only effect of such a solution is to shift the burden of those difficulties from one company to AI Exercise and other members of the industry. That is a solution which we sincerely believe to be inequitable and one which we respectfully request that the Ways and Means Committee decline to accept.

I have been authorized to state that Diversified Products, another exercise equipment producer, is in agreement with our opposition to the passage of H.R. 2913, as indicated in its written testimony dated August 27, 1985, submitted to the committee and signed by Richard L. Jenkins, vice president for finance and administration.

On behalf of Allegheny International Exercise Co., I wish to thank the committee for the opportunity to present the company's views on this bill here today.

Chairman GIBBONS. What is the real difference between the two speedometers?

Mr. STEWART. Mr. Chairman, we are happy that you asked that question. We happily brought some samples with us just in case someone might have an interest in that. We will be pleased to pass them up.

The speedometer consists of three parts, a speedometer head, which constitutes roughly 60 to 65 percent of the cost, a piece of cable and some form of mechanism to attach the cable to the tire.

The speedometer heads are identical. The cables are identical and the drive mechanisms are interchangeable; the sole difference being an 11-cent piece of plastic whose sole function is to change the direction of the speed indicator in the speedometer head.

It would be possible to have a third piece of plastic and, hence, have a triple gear which would merely reverse the direction back to that which a single gear does, to have a fourth gear which would make it the same as a double gear.

They serve no functional purpose other than to change the direction of the speed indication.

Mr. ENGLISH. Mr. Chairman, I would add of the three speedometers you have there only one would be classified under the bicycle speedometer provision as it now stands because two of them have a double gear at the end of the cable.

Mr. STEWART. In fact, Mr. Chairman, all of the units—whichever speedometer heads, cables or drive mechanisms accused—are offered and sold to any user, whether they be for use on a bicycle exerciser or for a regular bicycle. There has never been a distinction made by the foreign producers, by the U.S. producers and certainly not in the marketplace.

Chairman GIBBONS. How did we happen to get this huge differential in classifications?

Mr. STEWART. Goes back to the Tariff Act of 1930, Mr. Chairman. At that time there were two provisions. One was parts of motor vehicles and the second was for speed indication equipment. Paragraph 368(a) and 369(c). There were two judicial decisions, one in 1952, that said that speedometers used in motor vehicles or motorcycles were parts of motorized vehicles and were hence classified under 369(c). There was a separate case that dealt with speedometers that were used on bicycles and they were found to be properly classified under 368(a).

When the tariff act was amended in 1963 or when the tariff schedules were originally enacted in 1963, you had two provisions. You had a provision that called for speedometers capable of use on motorized vehicles which had the same low rate that paragraph 369(c) had, and you had a paragraph that had the high rate that was applicable to bicycles.

Stewart-Warner, who was then the only domestic producer of bicycle-type speedometers came in and said, "Ways and Means Committee, don't you see there is a problem. There are such things that are called mopeds which can take a bicycle type speedometer, a like construction unit as opposed to one of these heavy units that are used in a car or motorcycle or a truck and if you have the language suitable for use on a motorized vehicle you can have diversion."

So in the Technical Amendments Act of 1965, this Ways and Means Committee modified the two provisions from suitable for use on a motorized vehicle and other to read bicycle speedometers and other and in the House report indicated that the bicycle speedometer provision would take care of bicycle-type speedometers that might be used on motorized vehicles such as mopeds.

So that the concern that the class of bicycle type speedometers—certainly back in 1930 when speedometers were also used on exercise machines and in 1965, when they were used on exercise machines, no one thought that an exercise bicycle was going to move down the street and so there was no need to say "bicycle-type" speedometers because when used on bicycles or exercise equipment the two products have always been the same, and the same product has always been offered to both trades.

Chairman **Gibbons**. Let me interrupt here and say I have to go over and vote and I will be right back and look forward to some more of this discussion with both of you.

[Recess.]

Chairman **Gibbons**. Now, let's see. Have you finished?

Would you like to respond to what he just said?

Mr. **Gold**. Yes, I would.

I just would like to make one point, that there are two differences in a speedometer. A speedometer that is used in an exercise piece of equipment, number one, has a double gear and, number two, has its own face plate which has our logo and it is multi-colored and says "vigorous", "strenuous", and things like that.

The other point is that we have never used a speedometer in anything but an exercise bicycle and to my knowledge no one in the exercise business has used speedometers for other than exercise—that is speedometers they bought for exercise equipment were used only in exercise equipment.

Chairman **Gibbons**. I am still trying to figure out how we have got the same piece of machinery and one has got a real high tariff and the other one has a real low tariff.

Mr. **Belanger**. Mr. Chairman, I think the correct response to that basically is that, as you well now, there are thousands of tariff classification provisions depending on use and these are, however slight the difference in the two types of speedometers—and I will grant that it is somewhat slight—they are differently used and chief use controls as determined by both the Customs Service and the appellate court. I think that is why. That is the explanation for the difference.

Chairman **Gibbons**. Well——

Mr. **Stewart**. The change came about, Mr. Chairman, because a foreign manufacturer saw an opportunity to create a loophole in the law. The double gear, because it serves no functional purpose, did not exist until some trade counsel advised a client they could get around the bicycle tariff rate by adding additional piece of plastic.

That arose in 1980 and we have been in that situation since that time.

Mr. **English**. Mr. Chairman, one of the speedometers you have there has a silver face plate with the name "Huffy" on it. You will notice the dial reads counterclockwise.

Chairman **Gibbons**. I noticed that.

Mr. **English**. I put that together from our own products. The "Huffy" speedometer is a product we manufacture for Huffy with a single gear because Huffy is not interested in paying for a hub drive with an extra idler-gear due to the additional material and labor expense. However, Mr. Gold, I am sure, will be interested to know that I recently saw a Vitamaster speedometer that read counterclockwise on an exercycle with a double gear hub drive mounted on the right side of the wheel.

This entire controversy about double gears and single gears came about because many exercycles have chain drives mounted on the right side of the front wheel which precludes the mounting of the speedometer hub-drive on the right side. When a speedometer hub-drive, with a single gear is mounted on the left side of the front wheel, the speedometer generally reads counterclockwise. Therefore, some exercycle manufacturers said they needed a double gear hub-drive to get a clockwise reading.

It is, in my opinion, silly to think that the basis of purchasing an exercycle is the speedometer to begin with and for that matter, even more ludicrous to think that the speedometer's direction makes any difference.

However, the Customs Service on that basis did determine that double gear drives were used only for the exercycles. But bear in mind that the Huffy example disproves both points. Their hub-drives are single gear and mounted on the left side and their speedometers read in a counterclockwise direction. I think this shows that it does not really make that much difference whether the speedometer reads clockwise or counterclockwise.

The only reason the double gear hub-drive exists is for the purpose of getting a lower duty rate. That is really the only purpose for the second gear.

Mr. STEWART. Two years ago Mr. Gold's Vitamaster operation had nine models that were shown at one of the big trade shows, eight of which had the single gear and a clockwise reading, one of which had a double gear and clockwise reading.

Today, virtually all of their units have a double gear and the only reason for the double gear is to reduce the cost; namely, the cost of the duty and the result has been that Stewart-Warner, who used to supply most of what Vitamaster bought, now in 1985, receive none of what Vitamaster buys.

Chairman GIBBONS. Let me ask you. I can realize that a speedometer that goes on a bicycle or an exercise bicycle does not have to be as heavy as, say, a moped or a motorcycle or an automobile, but what does one of these things sell for?

Mr. STEWART. The manufacturer price to an OEM or to a distributor would be somewhere in the range of $4 to $5 for domestic and somewhere in the range of $3 to $4 for foreign imports, presently.

That would compare to a motorcycle or an automobile speedometer that would range up in the neighborhood of $25 to $35.

Chairman GIBBONS. It is amazing to me how we could have gotten ourselves into such an anomaly. I thought maybe by trying to understand how the anomaly came about we could figure out how to solve it, but that does not help a lot either, does it?

Well, thank you very much. I will return your—every time I get on my exercise bicycle, I will look down and think of these things. Maybe that is another good reason for me to stay off.

Mr. Schulze, do you have any questions about this?

Mr. SCHULZE. Just one, Mr. Chairman.

Everyone has said that to their knowledge these are not brought in to be used on an exercycle and then used on a bicycle, but, in fact, are they being used on bicycles? Yes or no? Do we have any proof?

Mr. STEWART. The answer in terms of Stewart-Warner's own model, Stewart-Warner responds to market demand, because one or two producers requested a model that had a double gear, many years ago we produced a double gear. We offer that to our bicycle distributors as well as to exercise manufacturers and sell it in kits. We sell lots of double gears.

Whether they are sold to distributors or whether they are sold to OEM, we do not keep straight records and there is no easy way to tell whether they are being sold out in the market place for use on bicycles or not.

Mr. SCHULZE. You are going to weaken your case. You are saying to me, no, you have no knowledge they are being used on bicycles?

Mr. STEWART. We have a kit we have in fact sold.

Mr. SCHULZE. I assume you are an attorney. I am trying to get a definitive answer because I am going to make a decision on this, yes or no. Are they being misused, are they causing the tariff schedules to be abused, and if they are being used on bicycles, it is being abused, then I am going to go one way.

If not, I am not going to be as concerned about it.

Mr. STEWART. Congressman, if you would go back to the 1965 legislative history where the provision was put in——

Mr. SCHULZE. I Understand the history. I understand what has happened.

Mr. STEWART. Certainly it is the case we have no evidence that the chief use of the double gear to date is on bicycles. If you are going to make the decision——

Mr. SCHULZE. Still not a very definitive statement, but thank you. I asked the question, but I really didn't get an answer.

Chairman GIBBONS. You could put them on a bicycle. There is no reason why you couldn't.

Mr. STEWART. Yes, sir.

Mr. ENGLISH. If you had an announced purpose to put them on bicycles, you could bring them in and they wouldn't be charged the duty rate available to the bicycle speedometer classification, if they were double gear.

Mr. STEWART. You can have them on both sides.

Chairman GIBBONS. Do you all agree with them if they were double gear they could come in under the——

Mr. BELANGER. I would ask them to repeat it, please.

Mr. ENGLISH. I said if you had a thousand bicycles and imported a thousand double gear speedometers with the announced intention of placing them on the bicycles, when they came into the Custom's territory of the United States, they would be classified as "other speedometers".

Mr. BELANGER. No, Mr. Chairman, I don't agree with that because if there were a substantial use actually of these imports on exercisers, then you would call into question, number one, what is the chief use and, number two, what is the class or kind. The class or kind would broaden.

Mr. STEWART. Mr. Chairman, we have the Customs Service here.

Chairman **Gibbons**. Do you want to referee this thing for us? Come on over there.

Mr. **Belanger**. They did once.

Chairman **Gibbons**. How in the hell did we get in this mess? Suppose I was an importer and I imported a lot of double gears and slapped them on bicycles; what would you do?

Mr. **Arnold**. What would the duty be?

Chairman **Gibbons**. Suppose I am an importer and import a lot of these double gear, low tariff speedometers and put them on bicycles; what would you do to me as an importer?

Mr. **Arnold**. Under the appellate court decision, they would come in at the lower rate as parts of the exerciser. They wouldn't take the bicycle speedometer rate. The appellate custom court has so held.

Chairman **Gibbons**. Even if the Customs inspector said to me as the importer how are you going to use these, Mr. Gibbons, and I said, well, I am going to put them on bicycles, but they have got two of those little gears down there so——

Mr. **Arnold**. I don't think that would make any difference.

Chairman **Gibbons**. Wouldn't make any difference.

Mr. **Arnold**. Not for that individual shipment anyway.

Chairman **Gibbons**. So if it has got two gears, aren't you going to charge that low rate?

Mr. **Arnold**. We have to. The appellate court has so held and our decision so held, too.

Mr. **Belanger**. Mr. Chairman, if I may, I agree with Mr. Arnold, as to that individual shipment because then you would have a case of fugitive use and a fugitive use, under traditional Custom's practice, does not affect the chief use of a class or kind of article. But if it became substantial, that would change.

Chairman **Gibbons**. Do you agree, Mr. Arnold?

Mr. **Arnold**. Well, our original decision was based on the chief use theory, but in view of the fact that the appellate court has held that if it has this double hub gear, it takes the lower rate, not the bicycle speedometer rate. We would have to follow that irrespective of how it is used.

Chairman **Gibbons**. Even if you knew I was going to use it for bicycles?

Mr. **Arnold**. I should think so. There is nothing in the court decision that puts it on an actual use basis like that.

Mr. **Stewart**. We handled the case in the appellate court. The appellate court decision affirms the Customs decision. It was a use provision, so if we got to the point where 51 percent of the units were being used on bicycles, then there would be a basis to go back and get a reclassification, but if 49 percent were used bicycles and 51 percent used on exercisers, we come in under the lower rate.

Mr. **Belanger**. I don't entirely agree with that. There is another factor to consider. If the use on bicycles were substantial, not necessarily 50 percent, but substantial, then a domestic manufacturer, Stewart-Warner, could come back and say now we have proven these are all one class or kind because they were all used the same way.

The court's decision was based on the fact that they are different classes and kinds of merchandise because they were used differently.

Chairman **Gibbons**. How in the world did we get tariff rates that—I guess you would have to go back and talk to the negotiators.

Do you all have any insight why in the world we got tariff rates that different?

Mr. **Stewart**. That is very interesting, Mr. Chairman. Stewart-Warner was the only company who appeared before the special trade representative, Trade Policy Committee, back in 1977, when that committee requested views on exceptions to the 60 percent tariff rate cut that were going to be negotiated.

Stewart-Warner appeared and Stewart-Warner said, "Look, we produce bicycle speedometers, and bicycle speedometers are used on bicycles and are used on exercise bicycles. We have been seriously harmed, and you should not reduce it by the full 60 percent."

There was at that time no request by any importer. There was no testimony by any other party that suggested all bicycle-type speedometers, which at that point in time were still classified under 711.93, were not going to be treated the same. In fact, we went in because the tariff rate on all bicycle-type speedometers in 1977 was at the 27.5—that which pertained to 117.93, and the single classification changed only after that fact and the negotiators did not make a distinction between the products.

That is the reason that the modification back to include all bicycle type speedometers would not constitute a violation of our agreements.

Mr. **Belanger**. Mr. Chairman, I don't think anyone in this room is qualified to read the minds of the negotiators at the time of the tariff schedules. The point I think that the gentleman from Stewart-Warner is not raising when he talks about the negotiations was that there really was no exercise bicycle market at that point in time, and you had a classification for bicycles speedometers and classification for other speedometers.

This was really a subsequently created article that falls within the parameters of a tariff provision with a lower duty rate.

Mr. **Stewart**. Mr. Chairman, that isn't true. We brought a dumping case in 1971 on bicycle speedometers from Japan specifically defined to include speedometers used on bicycles and speedometers used on exercise machines. Two of Stewart-Warner's largest accounts at that time—where we had lost business—were exercise producers. It was not the case back in 1977.

By 1977 there were three attempts by U.S. importers to get speedometers they claimed were used on exercise bicycles classified under 711.98 and all three of those attempts, two in 1967 and one in 1977 were all denied. They were all viewed as being capable of use on mobile bicycles and hence classifiable under 711.93. So it is not the case that the negotiations—that there could have been any confusion.

At that time, the administration of the law was clear. If an item was capable of use on a mobile bicycle, it was treated as a bicycle speedometer. We were the only producer then. We presented testimony to the Trade Policy Staff Committee.

There wasn't a single question that said don't you have to treat speedometers used only on exercise bicycles differently than those used on mobile bicycles? It makes no sense from a business point of view. Those things are produced out of the same inventory on the same line by the same workers, and are a mix and match variety.

Chairman GIBBONS. You helped me understand it a little better. I am not real positive about what I am going to do about it.

Mr. Frenzel, would you like to get involved in the bicycle speedometer exercise speed——

Mr. FRENZEL. The time of my entry coincides with the dispensing of this panel.

Chairman GIBBONS. Maybe it has. Thank you very much for helping us with this.

We have a bill, H.R. 839 by Mr. Schulze relating to the marketing of containers of imported mushrooms. The American Mushroom Institute, Mr. Charles Harris, the Pennsylvania Farmers' Association, James Yeatman.

Mr. SCHULZE. If I may, I would like to welcome these two gentlemen from Chester County, and express my appreciation to them for them taking the time and coming down to testify on this important topic to Pennsylvania, and the fifth district.

Chairman GIBBONS. I want to tell you if you are dissatisfied with what happens about mushrooms, don't blame it on Mr. Schulze. He has worked us over on mushrooms. He has tried everything from—I was going to say bribery, but that is against the law—with delicious mushrooms from Pennsylvania to endless hours of discussion about the qualities of mushrooms and their environment.

We are happy to have you here. You may proceed as you wish.

STATEMENT OF CHARLES R. HARRIS, EXECUTIVE DIRECTOR, AMERICAN MUSHROOM INSTITUTE

Mr. HARRIS. Mr. Speaker, members of the committee, my name is Charles Harris, and I serve as executive director for the American Mushroom Institute, 907 East Baltimore Pike. The American Mushroom Institute and its nearly 150 growers respectfully seek enactment of H.R. 839 which was introduced by U.S. Representative Richard T. Schulze of Pennsylvania.

H.R. 839 amends the 1930 Tariff Act to require containers of imported processed mushrooms to have label identification of the country where the mushrooms were grown. This would amount to a minor, but significant change in current law, which merely requires identification of the nation of last processing.

It is important to understand that H.R. 839 would neither impose protectionistic barriers against foreign trade partners, nor mandate excessive, unreasonable labeling standards.

The provisions of H.R. 839 are completely justified for ensuring the disclosure of pertinent information to America's consuming public. Indeed, without the information mandated by H.R. 839, unsuspecting American consumers would be misled into the potentially harmful belief that their canned mushrooms were grown under America's rigorous health and safety standards. Consumers have the right to know whether the mushrooms canned by American processors were also grown in accordance to American standards.

Under current law, this vital information is withheld from the public. H.R. 839 would enable informed, intelligent, consumer choices by removing the confusion and false impressions created by such deficient labeling.

Knowledge of a mushroom's origin of growth is no idle concern. Random inspections by the U.S. Customs Service have documented an alarming incidence of foreign matter present in imported processed mushrooms. Unfortunately, not every can of mushrooms which reaches our shores from overseas can be inspected.

Equally troubling is the reluctance of such nations as the People's Republic of China to reveal their growing and processing practices. American experts have been kept in ignorance by the PRC, for example, on such critical health factors as to composition of that nation's mushroom-growing compost.

Unfortunately, H.R. 839 cannot guarantee that every foreign shipment of mushrooms is properly inspected for the benefit of American consumers. Nor can H.R. 839 ensure that foreign mushroom agricultural practices are as safe or healthful as their American counterparts. Perhaps those issues warrant the further scrutiny of this Congress. Until that time, however, the public deserves, at a minimum, to have the benefit of full disclosure regarding the processing and growth origins of the canned mushrooms on American merchants' shelves.

Finally, it is regrettable that H.R. 839 cannot reverse the People's Republic of China predatory trade practices which have pushed America's mushroom industry to the brink of collapse. From little more than one-quarter million pounds exported to the United States in 1979 to over 43 million pounds which entered in 1984, the People's Republic of China has virtually displaced American-grown mushrooms from United States processing markets. And with the loss of those markets, our Nation also lost many jobs and sunk deeper into a balance of trade deficit. This deficit reached unprecedented heights in 1985 and also set a new record for monthly balance of trade in December 1985.

Until long overdue trade reforms are established on a broad scale, however, at least H.R. 839 would alert sensitive consumers to canned mushrooms whose purchase would further harm the economic survival of American growers.

The American Mushroom Institute is convinced that enactment of H.R. 839 is necessary to protect the public welfare and would impose no unreasonable burden on responsible parties here or abroad. No legitimate interest would be served, moreover, by withholding the information which H.R. 839 seeks to disclose.

The American Mushroom Institute sincerely requests favorable action on H.R. 839 as expeditiously as possible. Mr. Chairman, thank you for the opportunity to present these views.

Chairman GIBBONS. Thank you, sir.

Do you have a statement, too sir?

STATEMENT OF JAMES YEATMAN, FARMER, PENNSYLVANIA FARMERS' ASSOCIATION

Mr. YEATMAN. Yes, I do.

Mr. Chairman, members of the committee, my name is James Yeatman. I own and operate a mushroom farm at RD No. 1, Box 477, Avondale, PA 19311. I am here today to testify on behalf of the Pennsylvania Farmers' Association. PFA, with 23,300 family members, is the largest farm organization in our State. WE are affiliated nationally with the American Farm Bureau Federation.

Pennsylvania produces more mushrooms than any other State in our Nation. During 1983–84, production in our State totaled 279,654,000 pounds. In 1984, canned mushrooms were produced by 21 United States firms, 8 of which were located in Pennsylvania. Forty-five percent of Pennsylvania mushrooms were processed in 1983–84.

The Pennsylvania Farmers' Association supports H.R. 839, introduced by Congressman Richard Schulze. This proposed legislation would provide that imported preserved mushrooms would not be in compliance with U.S. trade laws unless the containers indicated in English the country in which mushrooms were grown. This is a significant change from current law which only requires identification of the nation of last processing.

A problem arises when imports of canned mushrooms preserved in heavy salt solutions enter this country in large containers. These mushrooms do not meet standards of identity for canned mushrooms. Upon arrival in the United States, these mushrooms are washed and conventionally processed and packaged by domestic firms. The labels on these packages of preserved mushrooms bear the identification of the United States rather than the country from where the mushrooms were grown.

Domestic mushrooms are produced under rigid health and safety standards. Conditions under which mushrooms are grown and processed in other countries cannot always be guaranteed. The Pennsylvania Farmers' Association strongly believes that labels on preserved mushrooms should allow consumers to easily distinguish high quality American mushrooms from imports. Anything less than a strict labeling standard represents a breach of trust between American producers and consumers.

This concept is so basic that voting delegates at our organization's recent annual meeting adopted policy that would require all imported agricultural products to be labeled as to the country of origin. Without such a provision, our industry has no defense against imports that appear to be domestically grown.

I thank the members of the Subcommittee on Trade of the Committee on Ways and Means for allowing me to present the views of the Pennsylvania Farmers' Association. I urge you to act quickly and favorably on H.R. 839.

Chairman GIBBONS. Mr. Schulze?

Mr. SCHULZE. Thank you, Mr. Chairman. Thank you, Jim and Charlie, both for testifying.

Mr. Chairman, I would ask that my statement be placed in the record as well.

Chairman GIBBONS. Certainly.

[The statement of Mr. Schulze follows:]

STATEMENT OF CONGRESSMAN RICHARD T. SCHULZE ON H.R. 839

Mr. Chairman, I appreciate the opportunity to express my strong support for H.R. 839, which requires that imported containers of mushrooms indicate in English the country in which the mushrooms were grown. I introduced this bill for very important reasons, the basic points of which I'd like to now briefly mention.

Let me start by saying that growing mushrooms is not just a delicate process, it's a detailed process. It involves many highly-specialized and time-consuming steps, such as preparing composte and closely monitoring necessary temperature changes throughout the production cycle. American mushroom growers must adhere to strict health and safety standards to ensure that deleterious bacteria and fungi do not develop. These standards are mandated by the U.S. Department of Agriculture and the Food and Drug Administration.

The most important reason for enacting H.R. 839 is that the American consumer should be informed about where mushrooms are grown due to the potential and serious health hazards associated with mushroom production. Witness the thousands of imported canned mushrooms that have been recalled in times past because of their harmful contents.

Mushrooms entering the United States from overseas have been detained at the port of entry by the U.S. Food and Drug Administration for a variety of rather disturbing reasons. One reason for refusing entry to shipments of canned mushrooms is the significant amount of "insect parts" often found to exist in imports of canned mushrooms.

The most dangerous health hazard related to imported canned mushrooms is that very toxic insecticides are used by overseas growers.

Toxic residues, including DDT and, even the much more toxic Lindane, have been found in samples of imported mushrooms. These and other similar dangerous insecticides have been banned in the United States for many years.

It is impossible for our already-understaffed Customs Service and FDA to carefully monitor and inspect each shipment of imported mushrooms because of their limited resources and the growing number of imported mushrooms. This is not a new problem. In 1983, for instance, the FDA recalled 14,000 cans of mushrooms that had passed through Customs' and FDA inspections upon entering the United States and had reached U.S. store shelves. They were recalled because of possible "under-processing," meaning that they may not have been sufficiently heat-treated, a procedure which is necessary to kill potentially toxic bacteria.

There is no doubt in my mind that the American consumer needs to know where the mushrooms they consume are being grown, precisely for the reasons just stated. Clearly, the consumer would benefit from such knowledge by labelling canned mushrooms appropriately.

The opposition voiced by the U.S. Departments of States and Agriculture does not stand on firm ground. Contrary to claims made by these two agencies, enactment of this bill will not lead to burdensome regulations. In fact, the International Trade Commission, in its examination of H.R. 839, reported that "any increased cost of production in changing container labels to conform to the bill would be minimal."

The provisions of H.R. 839 are not intended to be burdensome, nor will they require that canned mushroom labels include the names of several countries. In most every instance of imported canned mushrooms, this bill will require the addition of only one other country on the label—the country in which the mushrooms were grown. For example, a canned mushroom label would say "grown in China" and "canned in Macau." This is not a laborious task to accomplish.

Additionally, I do not believe that H.R. 839 violates existing rules on the marking of imported merchandise. Under current law, the country-of-origin labelling of an imported good is marked according to where the last "substantial transformation" of the product occurred. The complicated process of growing mushrooms and the process of preparing them in a brine solution and/or placing them in industrial containers before shipping them to another country for canning is an obvious case of substantial transformation. It is as important, if not more so, to know where mushrooms are grown, as it is to know where mushrooms are canned.

There's a strong case to be made for labelling imported canned mushrooms according to where they were grown. Producing this agricultural product does not require the involvement of many countries, as frequently occurs with manufactured goods. As already mentioned, usually one or two countries, at most, participate in producing canned mushrooms. Furthermore, agricultural products are unlike manufactured goods in many respects. They've always been treated differently as traded items and there is no reason why this shouldn't be the case with regard to mushroom country-of-origin labelling.

It is apparent that the way in which the U.S. Customs Service determines the last substantial transformation of an imported product is not clear cut. For example, it was recently determined that imported pistachio nuts, which were further processed (roasted) and packaged in the United States should be labeled according to where the pistachios were grown. Imports of textiles and apparel and frozen orange juice concentrate also demonstrate the varied use of country-of-origin regulations. The whole question of what is and what is not a "substantial transformation" seems to be a very gray area, which merits more attention on both a Congressional and Administrative level.

Another reason why H.R. 839 should be enacted is related to our nation's huge trade deficit, which hit another infamous record in 1985 of some $150 billion. The enormous influx of imports into this country has gravely harmed our agricultural and manufacturing sectors. Canned mushroom imports alone have increased about 44% since 1980 and now account for over 50% of the U.S. market.

In closing, I'd like to say that it's very well known that textile and apparel products are "crafted with pride" by our U.S. workers. I want all Americans to know that mushrooms are "grown with pride" by American mushroom growers. Enactment of H.R. 839 would be the right step in that direction.

Mr. Chairman, I urge my colleagues to support this bill. Thank you.

Mr. **SCHULZE**. Mr. Chairman, let me state for the knowledge of the committee that we did have requests from at least half a dozen and perhaps even more than that of others who wished to testify. But in interest of the time of the committee, we narrowed it to two.

There was a recent request by a professor from, I think the University of Delaware, who had been looking into this, that he be allowed to testify as well, and I am going to try to get a statement from him because he has been looking into problems with contamination of imported mushrooms and what he has to say is very important, and covers the main thrust of our argument. Our concern is for the well-being of the consumer.

Mr. Chairman, do you know whether anybody from the administration is still here? I was not here when they testified.

Chairman **GIBBONS**. Yes, we do have a witness.

Mr. **SCHULZE**. Would it be possible for them to come up at this time as well? I wonder if those of you involved in the mushroom discussion from the administration would come forward. We have them here. Just come forward and identify yourselves for the record.

STATEMENT OF EDMOND MISSIAEN, DEPUTY DIRECTOR FOR ANALYSIS, HORTICULTURAL AND TROPICAL PRODUCTS, FOREIGN AGRICULTURAL SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. **MISSIAEN**. My name is Edmond Missiaen. I am with the U.S. Department of Agriculture.

Mr. **SCHULZE**. I wonder if you could tell me about the administration's position as to whether this would be a trade barrier or nontariff barrier.

Mr. **MISSIAEN**. I will try to defer to the more technical part of this answer. But——

Mr. **SCHULZE**. Let's start with the agricultural end of it. Are there any other foods labeled by country of origin?

Mr. **MISSIAEN**. As far as I know, all foods are labeled by country of origin in the packaging they entered in. If they are further processed in the United States or some other country, they are labeled by the country in which the last processing took place.

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Mr. SCHULZE. The amount of processing doesn't make any difference?

Mr. MISSIAEN. As far as I know, no.

Mr. SCHULZE. Is that the USDA's regulation?

Mr. MISSIAEN. That is not a USDA regulation.

Mr. SCHULZE. Is it last or is it substantive?

Mr. MISSIAEN. Last substantive is my understanding.

Mr. SCHULZE. Last substantive?

Mr. MISSIAEN. Yes. That is not my field of expertise.

Mr. SCHULZE. I am trying to get back to agriculture. It seems to me that with agricultural products, we have something a little unique, as opposed to some type of machinery. There are two different things, growing a product and growing a product that is the major portion of that product.

Would you agree from the Department of Agriculture standpoint? Are you familiar with what we have done with pistachios?

Mr. MISSIAEN. I understand with pistachios we have a new labeling law, yes.

Mr. SCHULZE. What is the administration's position on that?

Mr. MISSIAEN. I was not involved with that issue.

Mr. SCHULZE. How long have you been with the Department of Agriculture?

Mr. MISSIAEN. I have been with the Department of Agriculture for 18 years, sir.

Mr. SCHULZE. Maybe I had better let you tell me then.

Mr. MISSIAEN. My understanding of mushrooms is that most of the mushrooms are grown in one country and processed in another country, and generally that processing takes place in Hong Kong. Mushrooms are imported in brine, in bulk to Hong Kong where they are canned and exported to other countries, mainly to the United States.

I understand this same procedure is now beginning to happen in the United States. We are beginning to import into the United States mushrooms in brine, which are then reprocessed or further processed in the United States and put into cans or bottles. Most of the mushrooms that we import are still imported in the end container, be it a No. 10 can or a consumer sized can.

Mr. SCHULZE. From an agricultural standpoint your concern is the health and safety of the consumer?

Mr. MISSIAEN. I work with the Foreign Agricultural Service, and we are concerned with tracking of trade. The USDA is concerned with the health of the consumer, but I personally do not work with the Animal, and Plant Health Inspection Service, which is involved in those inspection types of procedures.

My expertise is in the volume, quantity, and trends of trade.

Mr. SCHULZE. I am trying to understand. I would guess the Department's main thrust would be concern over the purity of agricultural products as they came in. Would you agree with that?

Mr. MISSIAEN. Among the many things we are concerned about, we are concerned with that question.

Mr. SCHULZE. Are you familiar with the types of pesticides used in other countries which are banned in this country, DDT and others?

Mr. MISSIAEN. In a general sense, yes. In a technical sense, no.

Mr. SCHULZE. Well, I understand that DDT and glandine, both—glandine is more toxic than DDT—have been found in imported canned mushrooms, and my concern, I guess, is how the Department of Agriculture feels this should be controlled or how we should inform the public about it.

Do you feel better labeling requirements as to the contents would be beneficial? My main concern is health and safety. I am not interested in building walls and barriers and keeping out foreign mushrooms. I am concerned about the way those products, whether they are mushrooms, pistachios, or potatoes, how they are grown and whether they are relatively pure products, and the standards are high as they come in.

How do you feel the Department of Agriculture would best go about this?

Mr. MISSIAEN. The Department of Agriculture is responsible for inspecting for the healthfulness of unprocessed products. The inspection of canned goods is done by the Food and Drug Administration.

Mr. SCHULZE. Don't they put out regulations for determining how mushrooms are processed and grown in the United States?

Mr. MISSIAEN. FDA is responsible. On how they are grown, I guess that is the Department of Agriculture, yes.

Mr. SCHULZE. OK. Let's get back to the testimony that you felt this would be some kind of a nontariff barrier and impose an undue cost, if I understand it. Is that correct?

Mr. MISSIAEN. That is correct, sir.

Mr. SCHULZE. Would you elucidate for me in a little bit more detail? I hear from canners and growers that this marking would not be a barrier. In other words, everyone knows Toyotas are made in Japan. Consumers don't stay away from them because of that.

The country of origin—unless you have got major problems, should not be a nontariff barrier.

Mr. MISSIAEN. In this case we are not necessarily talking about the end country of origin. If we import mushrooms from Hong Kong the canner in Hong Kong may use mushrooms from Taiwan or China, most likely from China, from the People's Republic. But that product is labeled Hong Kong, because the Custom's inspector knows that the can of mushrooms he has got came from Hong Kong, but he has no way of knowing where the canner got the mushrooms, and it is our understanding that this would be an administrative burden in order to determine where the actual mushrooms were grown. We easily know where the last place they were transformed, but not where he got them from.

Mr. SCHULZE. It seems to me substantial transformation is spelled out pretty clearly and it would not be a great deal of problem to determine through the use of invoices. I have been to Hong Kong and they tell me it is no problem to determine country of origin.

They are pretty strict on what comes in and out and there are plenty of records and it can easily be determined. So if you can send me some documentation where you really think this would cause a major problem, I would be happy to look at it. The arguments that you are putting up have been pretty well refuted by people on the other side.

If you have some facts that you can show me to confirm it really would be a problem, or if Customs feels that it would be an excessive burden, I would be happy to hear from them. But my understanding is that in talking to the authorities in Hong Kong that they do not feel that it would be overly burdensome.

Mr. MISSIAEN. I can't contest that.

Mr. SCHULZE. Thank you.

Now, the other argument was that the cost would be prohibitive. My understanding is that the cost of the labelling is the same whether you put the country of origin as Hong Kong or whether it was grown in the People's Republic of China or Taiwan, and that the consumer acceptance is the same. It really doesn't make any difference.

Do you want to explain any further why the cost would be a problem?

Mr. MISSIAEN. I don't have specific knowledge on the cost of labelling.

Mr. SCHULZE. Any other reasons that the administration would have to oppose this measure?

Mr. MISSIAEN. I think our basic argument was that it is not easy to enforce.

Mr. SCHULZE. Because of determining the country of origin.

Mr. MISSIAEN. Yes, sir.

Mr. SCHULZE. If the Hong Kong authorities tell you it would not be that difficult to determine, would that change your mind?

Mr. MISSIAEN. I imagine it would help. I can't tell you—I am not in a position to tell you if it would change our mind.

Mr. SCHULZE. I thank you.

Gentlemen, do you have anything to add, as you have heard the administration's position? I think, Jim, you have been to Hong Kong, haven't you?

Mr. YEATMAN. No.

Mr. SCHULZE. I know a group went over there a couple years ago. Anything that you would like to add?

Mr. YEATMAN. I can't understand the argument of the difficulty of determining country of origin at all. It just doesn't sit well with me.

Mr. SCHULZE. Jim, maybe if you would very briefly for me tell me about the standards you have to go through in producing and canning mushrooms in this country, rules, regulations of cleanliness, and so forth.

Mr. YEATMAN. I don't think we have time. They are very extensive, of course, from growing all the way through the processing.

In the growing, we must comply with many regulations and follow product labels. We use only labeled products which are becoming fewer and fewer because of the difficulty in getting label registrations. And in the processing it is the same thing.

The mushroom industry has been looked at very, very closely in the last 10 years because of the problems about 10 or 12 years ago. To be a canner in the mushroom industry today you have to be good. You have to meet all compliance regulations and meet them regularly, because we are inspected regularly.

Mr. SCHULZE. Are you inspected by the U.S. Department of Agriculture?

Mr. **Yeatman**. The canning facilities are inspected by the Food and Drug Administration, as you well know, not by USDA.

Mr. **Schulze**. The State and county, as well.

Mr. **Yeatman**. No. The inspections are by FDA in the processing. In the growing, we have mushrooms picked up on occasion. These fresh mushrooms are analyzed for chemicals or whatever by FDA. USDA also inspects the growing entity. There are many regulations which we must comply with, and do, in the growing and processing.

Mr. **Schulze**. Thank you.

Charlie, do you have anything you would like to add?

Mr. **Harris**. No.

Mr. **Schulze**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you, Mr. Schulze.

Does anyone else have any questions?

Mr. **Frenzel**. Yes. Mr. Chairman, I think while the witnesses are here, it would be well to have their comments on what our staff book here calls technical comments. The first relates to the term "preserved" which is used in the bill, and that the term is not used by itself in the tariff schedules. There we are talking about otherwise prepared or preserved mushrooms, at least that is one of the items.

Would it make any difference to the bill if we conformed it to the TSUS?

Mr. **Yeatman**. These mushrooms in brine are considered preserved, aren't they?

Mr. **Frenzel**. It is simply a case I think of a tariff description, and I don't know if what you are trying to get at is covered by that tariff item or not. I assume this would be an easy matter to discuss and take care of.

It doesn't look like——

Mr. **Schulze**. I think it would. What we are trying to determine is as opposed to fresh. And there are many types of preservation.

Mr. **Frenzel**. But I don't think it would hurt your bill if you followed the TSUS items.

The second technical comment which is alleged to be more significant is that the legislation addresses only the marking of imported mushrooms which would be required at the time of entry. It wouldn't eliminate the problem of the final U.S. consumers' lack of country of origin information about bulk imports intended for further processing and canning after entry.

That is for whatever processing we are doing in this country. The consumer would then know—under your bill a consumer would know about some imports, which would be the little cans and jars that would sit on the shelf.

They wouldn't know about stuff processed in this country and put into little American cans and jars.

Mr. **Schulze**. Perhaps I can respond to that. Let me say the bulk of what is coming in now is being used directly by those who use large quantities of mushrooms at the retail level, pizza chains, for instance. There is not a great volume being now transformed and canned and sold at the retail level, and consequently we did not feel this was a problem. If it does grow to the point it is a problem, we would be happy to address it.

Mr. **Frenzel**. The third item relates to imports of canned mushrooms which have been canned before they come in. The legislation appears to be unnecessary in light of existing marketing requirements of section 304 of the Tariff Act. However, if the intent of the legislation is to require that the bulk canners of imports be marked, maybe that would require another amendment.

Mr. **Schulze**. That is what I say, if that proved to be a problem later on, we don't foresee that happening, but we could address that at another time if it becomes necessary.

Mr. **Frenzel**. The last objection is that the bill could be viewed as a creation of a trade barrier because it could impose a burden on processors also, assuming it were amended to require processors to mark all production in the country, as having been produced in whatever country it was grown in, and here I just wanted to remind the witnesses while Mr. Schulze represents the predominant mushroom production area in the United States, I represent the largest single importer of mushrooms in the United States and so we sometimes have slightly varient views as to how we should proceed.

I think this is something that we all have to discuss at greater length and see if we can work something out that works to everybody's advantage. I yield back the balance of my time.

Chairman **Gibbons**. All right. Thank you, gentlemen.

Mr. **Harris**. Thank you, Mr. Chairman.

Chairman **Gibbons**. The next one is my bill dealing with fur skins. And we have one witness from the American Fur Resources Institute, Mr. Boynton. Mr. Boynton, come on in. Fire away.

STATEMENT OF STEPHEN S. BOYNTON, WASHINGTON COUNSEL, AMERICAN FUR RESOURCES INSTITUTE

Mr. **Boynton**. Thank you, sir. My name is Stephen S. Boynton, and I am Washington counsel for the American Fur Resources Institute. AFRI represents trappers and rural fur buyers throughout the Nation and was created to promote appropriate legislation and regulation that supports scientific and professional wildlife management on a State and National level. In addition, AFRI supports efforts and programs to assist the U.S. domestic production of fur in being competitive in the world markets. We sincerely appreciate the opportunity to testify before your subcommittee today on H.R. 3019 which would lift the 34-year-old ban on the importation of seven wild furs from the Union of Soviet Socialist Soviet Republics. The raw fur pelts in question are mink, muskrat, weasel, ermine, kolinsky, which is an Asiatic mink, fox, and marten. Mink, muskrat, fox, and marten are produced in the United States from the wild and from ranching operations.

There are over 750,000 men, women and young people who are trappers in this nation who produce between $300 and $400 million worth of wild fur pelts annually. In addition, there is a viable industry in farmed fur in this country. Trappers and members of the fur industry vigorously support wildlife conservation and sincerely believe that, through proper professional wildlife management as administered by the States, the renewable fur bearer resources can be utilized for the benefit of wildlife and man. The harvest of fur bearers in concept is absolutely no different than the harvest of sheep, cattle, swine or chickens in that these species are renewable resources which man can appropriately utilize when sufficient breeding populations are maintained. The total fur trade in the United States is a billion dollar industry, and, as this committee is aware, one of the few domestic industries that enjoys a favorable balance of trade.

Consequently we believe one of the specific issues before this subcommittee is the economic impact the legislation to amend the tariff schedules of the United States to permit importation of certain raw fur skins from the USSR would have on U.S. domestic fur production.

First of all, AFRI would applaud the efforts of the administration to seek an improvement in the bilateral trade relationship between the U.S. and the U.S.S.R. The 10-year extension of the Long-Term Agreement on Economic, Industrial and Technical Cooperation, we believe, is a positive political and economic opportunity for the people of both nations.

Our concern with the pending legislation is that there has not been, to our knowledge, a thorough analysis of the possible adverse economic impact such a lifting of the embargo would have on U.S. wild and farmed fur. In fact, statements have been made that would indicate that such a thorough analysis may be irrelevant due to other considerations. We would hope not.

Secretary of Commerce, Malcolm Baldrige stated this morning and on October 9, 1985, before the Subcommittee on Trade Productivity and Economic Growth of the Joint House-Senate Economic Committee that the "[e]limination of this embargo is definitely in the economic interest of the United States" and that "[t]he negligible economic cost of eliminating the fur skin embargo is outweighed by far by the economic gains to the United States which result from the Soviet steps to provide us with greater market access."

The limited analysis that has been made by the Department of Commerce is misleading in its conclusions. A major point has been made that since the embargo never covered fur coats and other garments that are competitive with United States and other foreign-made garments, the proposed bill should not be of concern. It should be noted, however, that the majority of the garments from Russian fur are sable that amount to 98 percent of the total quantity of imports and 95 percent of the value. There is no sable of this quality produced in the United States or other countries and is a unique product to Russia.

A second point made in what analysis that has been offered by the Department of Commerce is that, since 75 percent of the 4.5 million ranch mink pelts are exported from the United States, farmed mink production would not be affected by a removal of the import embargo. Further, that since the Soviet fur industry is a "mature one", any increase in Soviet exports of fur skins to the United States "will probably result in a decrease in exports to other markets."

First of all, the mink ranchers are presently having severe economic problems. U.S. mink are not competitively priced in world markets today because of the strong United States dollar and currently have competition from Scandinavian, Russian and, recently, Chinese mink pelts. Although we know that the U.S.S.R. offered 3.9 million mink pelts through auction in 1984, we do not know the extent of production and the potential supply for export. It is speculated that the annual production could be as high as 13 million pelts. Consequently, the potential impact of mink imports into the United States is not insignificant.

Further, we do not believe that it is unreasonable to request similar data on Russian production of fox, muskrat, and marten in order to properly evaluate potential import impact. The following represents a 14-year annual average value of the wild furs in question: 1970-71 to 1983-84: Marten, 26,391 pelts at a value of $886,473; muskrat, 6,272,172 pelts at a value of $27,597,557; mink, 300,414 pelts at a value of $1,450,999; red fox, 310,114 pelts at a value of $12,807,708; gray fox, 216,119 pelts at a value of $7,036,834.

This amounts to almost $50 million annually for wild fur sold for these species. Consequently, to thousands of men, women, and young people, this is not negligible. When considering the sales and farmed mink and fox fur, this total far exceeds the $240 million in contracts for machinery and equipment ordered by the U.S.S.R from the United States by the end of 1985.

Mr. Chairman, the embargo should not be considered just a longstanding irritant or just of symbolic importance, to quote Secretary Baldrige, that should be discarded without congressional study and review. If the result were to terribly impact the U.S. production of fur adversely, the maintenance of some control on imports should be considered.

It is realized this embargo was created as a political response in 1951. However, regardless of the creation of the ban, its removal should be considered in terms of present day impact domestically.

In addition to the economic considerations, there were wildlife management concerns which have been evidenced by the chairman of the Wildlife Subcommittee, Congressman John Breaux and the ranking minority member, Don Young, to this committee.

AFRI has received correspondence from trappers who can recall in the period from 1946 to 1950 when fox from the U.S.S.R. flooded U.S. market and fox pelt prices in the United States decreased to a point it was not to the economic benefit of the trapper to take fox. Consequently, U.S. fox population problems occurred, causing depredation and disease concerns. If there is no economic incentive for the trapper to trap certain species, tax dollars will be necessary to maintain animal population control.

In sum, Mr. Chairman, AFRI has not seen a clear cut economic justification for the removal of the embargo. Rather a political act to accommodate a broader purpose of trade. The possible and potential sacrifice of a part of U.S. industry to accommodate a symbolic gesture is not, we believe, in the best interest of our trade policy.

Given the fact that the Russian furs could cause harm to our domestic fur production, we submit it is not unreasonable to place certain controls on imports of those species that may be impacted. Such a limitation only insures the United States a place in the market, not monopoly nor protectionism.

The fur trade, Mr. Chairman, in the United States is our oldest industry. The return cargo of the Mayflower in 1622 was fur. Since that time, a viable fur industry has existed. The excesses in fur harvests of the 19th century cannot be and will not be repeated. Today furbearer populations are stable and healthy. We do not believe it is unreasonable to request Congress to carefully review our national trade policies to insure that this industry is not economically jeopardized. At this point, we do not believe that appropriate data has been submitted and properly analyzed to permit a proper Congressional response.

Mr. Chairman, thank you, and I would be happy to answer any questions.

[The prepared statement follows:]

STATEMENT OF AMERICAN FUR RESOURCES INSTITUTE

Mr. Chairman, my name is Stephen S. Boynton, Washington Counsel for the American Fur Resources Institute [AFRI]. AFRI represents trappers and rural fur buyers throughout the nation and was created to promote appropriate legislation and regulation that supports scientific and professional wildlife management on a state and national level. In addition, AFRI supports efforts and programs to assist the U.S. domestic production of fur in being competitive in the world markets. We sincerely appreciate the opportunity to testify before your Subcommittee today on H.R. 3019 which would lift the 34-year old ban on the importation of seven wild furs from the Union of Soviet Socialist Soviet Republics. The raw fur pelts in question are mink, muskrat, ermine, kolinsky (Asian mink), fox and marten. Mink, muskrat, fox and marten are produced in the United States from the wild and from ranching operations.

There are over 750,000 men, women and young people who are trappers in this nation who produce between $300 and $400 million worth of wild fur pelts annually. In addition there is a viable industry in farmed fur in this country. Trappers and members of the fur industry vigorously support wildlife conservation and sincerely believe that, through proper professional wildlife management as administered by the states, the renewable fur bearer resources can be utilized for the benefit of wildlife and man. The harvest of furbearers in concept is absolutely no different than the harvest of sheep, cattle, swine or chickens in that these species are renewable resources which man can appropriately utilize when sufficient breeding populations are maintained. The total fur trade in the United States is a billion dollar industry and, as this Committee is aware, one of the few domestic industries that enjoys a favorable balance of trade.

Consequently, we believe one of the specific issues before this Subcommittee is the economic impact the legislation to amend the Tariff Schedules of the United States to permit the importation of certain raw furskins from the U.S.S.R. would have on U.S. domestic production of fur.

First of all, AFRI would applaud the efforts of the administration to seek an improvement in the bilateral trade relationship between the United States and the U.S.S.R. The 10-year extension of the Long-Term Agreement on Economic, Industrial and Technical Cooperation, we believe, is a positive political and economic opportunity for the people of both nations.

Our concern with the pending legislation is that there has not been, to our knowledge, a thorough analysis of the possible adverse economic impact such a lifting of the embargo would have on U.S. wild and farmed fur. In fact, statements have been made that would indicate that such a thorough analysis may be irrelevant due to other considerations. We would hope not.

Secretary of Commerce, Malcolm Baldrige stated on October 9, 1985 before the Subcommittee on Trade, Productivity and Economic Growth of the Joint House-Senate Economic Committee that the "[e]limination of this embargo is definitely in the economic interest of the United States" and that "[t]he negligible economic cost of eliminating the furskin embargo is outweighed by far by the economic gains to the United States which result from the Soviet steps to provide us with greater market access."

The limited analysis that has been made by the Department of Commerce is misleading in its conclusions. A major point has been made that since the embargo never covered fur coats and other garments, that are competitive with United

States and other foreign made garments, the proposed bill should not be of concern. It should be noted, however, that the majority of the garments from Russian fur are sable that amount to 98% of the total quantity of imports and 95% of the value. There is no sable of this quality produced in the United States or other countries and is a unique product to Russia.

A second point made in what analysis that has been offered by the Department of Commerce is that, since 75 percent of the 4.5 million ranch mink pelts are exported from the United States, farmed mink production would not be affected by a removal of the import embargo. Further, that since the Soviet fur industry is a "mature one", any increase in Soviet exports of furskins to the United States "will probably result in a decrease in exports to other markets."

First of all, the mink ranchers are presently having severe economic problems. U.S. minks are not competitively priced in world markets today because of the strong U.S. dollar and currently have competition from Scandinavian, Russian and, recently, Chinese mink pelts. Although we know that the U.S.S.R. offered 3.9 million mink pelts through auction in 1984, we do not know the extent of production and the potential supply for export. It is speculated that the annual production could be as high as 13 million pelts. Consequently, the potential impact of mink imports into the United States is not insignificant.

Further, we do not believe that it is unreasonable to request similar data on Russian production of fox, muskrat, and marten in order to properly evaluate potential import impact. The following represents a 14 year annual average value of the wild furs in question.

1970-71 to 1983-84

Species	Pelts	Value
Marten	26,391	$886,473
Muskrat	6,272,172	27,597,557
Mink	300.414	1,450,999
Fox (red)	310,114	12,807,708
Fox (grey)	216,119	7,036,834

This amounts to almost $50 million annually for wild fur sold for these species. To the thousands of men, women and young people, this is not "negligible" but represents substantial secondary income. When considering the sales in farmed mink and fox fur, this total figure far exceeds the $200 million projected for machinery and equipment orders by the U.S.S.R. from the U.S. hoped for by the end of 1985 by the Department of Commerce.

Mr. Chairman, the embargo should not be considered just "a long standing irritant" of just "symbolic importance," to quote Secretary Baldrige, that should be discarded without Congressional study and review. If the result were to materially impact the U.S. production of fur adversely, the maintenance of some control on imports should be considered.

It is realized that this embargo was created as a political response in 1951 when President Truman, by executive order, placed a ban on these imports pursuant to the Trade Agreements Extension Act of 1951. Also, that the prohibition was placed upon imports from the Peoples' Republic of China which Congress removed the latter ban in 1983. Public Law 97-446. As to imports from the PRC, the impact is not a threat to domestic production as their fur industry is not as mature nor as sophisticated as the Russian fur industry. However, regardless of the reason for the creation of the ban, its removal should be considered in terms of the present day impact domestically.

In addition to economic considerations, there are wildlife management concerns. AFRI has received correspondence from the trappers who can recall in the period from 1946 to 1950 when fox from the U.S.S.R. flooded the U.S. markets, fox pelt prices in the U.S. decreased to a point that it was not to the economic benefit of the trapper to take fox. Consequently, U.S. fox population problems occurred causing depredation and disease concerns. If there is no economic incentive for the trapper to trap certain species, tax dollars will be necessary to maintain animal population control.

In sum, Mr. Chairman, AFRI has not seen a clear cut economic justification for the removal of the embargo. Rather, a political act to accommodate a broader purpose of trade. The possible and potential sacrifice of a part of U.S. industry to accommodate a symbolic gesture is not, we believe, in the best interest of our national trade policy.

Given the fact that the Russian fur industry could cause harm to our domestic fur production, we submit that it is not unreasonable to place certain control on imports of those species that may be impacted. Such a limitation only insures the U.S. a place in the market; not monopoly nor protectionism.

The fur trade in the United States is our oldest industry. The return cargo of the *Mayflower* in 1622 was fur. Since that time, a viable fur industry has existed. The excesses in fur harvests of the 19th century cannot and will not be repeated. Today, furbearer populations are stable and healthy. We do not believe it unreasonable to request Congress to carefully review our national trade policies to insure that this industry is not economically jeopardized. At this point, we do not believe that appropriate data has been submitted and properly analyzed to permit a proper Congressional response.

Thank you.

Chairman **Gibbons**. Thank you for your comprehensive testimony. Do members have questions here?

Mr. **Frenzel**. I have a question.

Chairman **Gibbons**. Mr. Crane first, and then Mr. Frenzel.

Mr. **Crane**. First I want to thank you for your testimony, and, second, inasmuch as Secretary Baldrige indicated in his testimony that they have made contact with the various people in the fur industry in the United States and had not encountered significant objections, I am curious to find out if he communicated with you, because I have seen commentary from the Northwood Fur Farms; the Wildlife Federation Fund of America. I have seen evidence at least of people representing the industry that apparently communicated that information to Secretary Baldrige. I am wondering where he got that.

Mr. **Boynton**. Congressman Crane, a two-part answer to that: First of all, we have indeed had meetings with the staff and the Secretary of Commerce and the American Fur Resources Institute has indicated its concern. We have, through the House Wildlife Subcommittee chairman and ranking member, evidenced that concern.

But the Department of Commerce's analysis that was done early on, prior to the introduction of the bill, made a statement that the organized portions of the fur industry in New York; namely, the unions, the fur merchants and associations and the manufacturers favored this legislation. That is totally in error, they do not favor this legislation. There were some individual members that expressed personal opinions concerning this legislation, but as far as the organizations are concerned, they are definitely opposed to it.

Mr. **Crane**. There was one other comment in his testimony where he talks about 80 percent of U.S. mink production being exported and suggests that that being the case, that the importation of mink from the Soviet Union would not have a dramatic impact on the fur industry.

Yet in reading your figures here, 1970, 1971, 1983, 1984, the respective values with muskrat at $27.5 million and red fox at $12.8 million and gray fox at $7 million, mink is only $1.4 million. All of these vary. Furs potentially, it seems to me, could be very dramatically impacted if the Soviets reverted to their export practices right after the war. Is that a true assessment?

Mr. **Boynton**. That is correct. Now the figures I have in my prepared testimony, Congressman, relate to those taken in the wild.

But there is a significant point and difference. The United States imports a lot of mink also, and it is used for different purposes, for trim, as opposed to matching lengths on coats. I think the point the Department of Commerce has missed here is that the U.S. mink export production is not suffering competitively now because of the strong dollar and influence of the Scandinavian and, indeed, mink from the Republic of China. I think the statement it would not impact the industry is an error.

Mr. CRANE. One other point. In his comment this morning, he indicated, he made the statement "While analysis indicates"—this is in his conclusion—"analysis indicates there will be little or no effect on the domestic fur skin industry," I am wondering what that analysis is. For example, the Wildlife Federation said they had requested information from the U.S. Department of Commerce, as have several Members of Congress, nongovernmental organizations. Nothing substantial, they say, has been received.

Has that been your experience too?

Mr. BOYNTON. Yes. There was an analysis made, and it was theoretical at best. I was informed this morning, coming here, the Department of Commerce had provided some figures to the staff of the House Wildlife Subcommittee regarding Soviet fur production. I have not had an opportunity to review those figures. But up until this morning, any analysis that the Department of Commerce made was theoretical trade analysis, it was not based on hard data. Any trade issues that we have heard here today or in the past, you can tell within a quarter of an inch how much textiles we are talking about to the pound-on steel and to the number of automobiles.

But for the administration to say their analysis said there will not be an impact or it will be negligible, without hard data, I believe is not a true analysis on which Congress should have to make their decision.

Mr. CRANE. I share your concern, and in the absence of such data, I think we are proceeding hastily to try to support the Secretary of Commerce's position, with all due respect to my distinguished chairman.

Chairman GIBBONS. We only have about 4 minutes left.

Mr. FRENZEL. Could I ask a quick question of the witness? On page 4, the third paragraph, the first line, last word, there is I think a typo in your presentation. You read it "severe", and it says "fewer". I think you want to make it "severe", and I want to make sure it gets into our record.

Mr. BOYNTON. I thank the Congressman for pointing that out. Thank you very much, sir.

Chairman GIBBONS. Thank you very much for that. We will have to recess now and come back immediately after this vote for our last bill, H.R. 2336. And we will meet tomorrow morning, bright and early.

[Recess.]

Mr. FRENZEL. Well, by the authority not vested in me, we will resume the hearing.

We will take up H.R. 2336, introduced by three members of the committee, Mr. Guarini, Mr. Vander Jagt, Mr. Russo, and Mr. Schulze. Mr. Vander Jagt asked me to welcome you, Mr. Bishop. He expressed his regret at not being able to be here and we would assume for the record so did the other authors. Will you please proceed as you wish.

STATEMENT OF JERRY BISHOP, GENERAL MANAGER, NUCLEAR ACTIVITIES, ALLIED-SIGNAL INC.

Mr. BISHOP. Thank you, Congressman Frenzel. My name is Jerry Bishop. I am general manager of nuclear activities for Allied-Signal Corp. My business responsibility is management of the business area which is responsible for conversion of uranium concentrates into uranium hexafluoride. This uranium conversion business is a small but very essential part of the nuclear fuel cycle. It fits in between the mining and milling of uranium where uranium concentrates or yellow cake is produced, and the enrichment of uranium, which is conducted in this country by the Department of Energy.

Our specific concern today that I would like to discuss with you—and it pertains directly to our support of passage of House bill 2336—is the Canadian policy on upgrading of uranium.

As you know, the Canadians have a policy which requires that all uranium produced in that country be upgraded to uranium hexafluoride prior to export. The Canadians very, very rigidly enforced this policy during the past 3 years. Because of this very rigid enforcement of this upgrading policy, we now find that the domestic uranium conversion industry is severely threatened. We hold that this Canadian upgrading policy is protectionist, that it is unfair and that it is inconsistent concerning the Canadian's own statements on the sale and marketing of uranium.

The Canadians do have a very significant advantage in natural uranium in that they have discovered very rich uranium ore deposits and they are taking advantage of those rich deposits of uranium. They, however, have no such natural advantage in the conversion of uranium hexafluoride and by the rigid enforcement of this uranium upgrading policy they have in fact created an artificial advantage for the Canadian producers.

Let me give you an example of why I claim that the Canadian policy is both unfair and inconsistent. During 1982, a bill was introduced in the Senate which would have somewhat restricted the use of foreign uranium in domestic nuclear reactors. This bill was very vigorously opposed by our friends in Canada. They argued very loudly on behalf of free trade and subsequently that particular bill was defeated. However, now, when we have argued with our friends to the north that they should reciprocate and engage in free trade and allow free competition for the conversion of uraniumn, they have refused to listen.

Our efforts over the past 3 years have included visiting and talking with officials of the Canadian Government. We have asked our administration here in Washington to intercede on our behalf and several letters have been written by Members of Congress to various high-level officials in Canada. All of this has been to no avail. That is why we now ask and strongly urge the passage of House bill 2336.

One other point I wish to make is that we are currently running a trade deficit with Canada which is in excess of $20 billion. With that kind of trade balance, it appears to me that Canada does not need a protectionist policy on uranium hexafluoride conversion. Because of that, and the other things I have mentioned, and the fact that this does pose an extremely serious threat to the domestic uranium hexafluoride conversion industry, we would strongly urge support and passage of House bill 2336.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF JERRY BISHOP, GENERAL MANAGER, NUCLEAR ACTIVITIES, ALLIED-SIGNAL INC.

SUMMARY

Canadian Government policy requires that all uranium exported be upgraded to uranium hexafluoride (UF_6) by Eldorado Nuclear, Ltd. a subsidized Crown Corporation.

By this policy, all U.S. and foreign UF_6 processors are prevented from competing for uranium hexafluoride conversion business using Canadian-source uranium.

The Canadian policy is inconsistent with recent Canadian positions favoring free access to U.S. markets for the sale of their uranium.

The Canadian upgrading policy is restrictive and unfair, and threatens to cripple the strategically important U.S. conversion industry, which is an essential link in our nuclear fuel supply cycle.

The U.S. Government has raised this issue with Canada numerous times over the last several years. These attempts have met with failure.

Allied strongly supports the passage of H.R. 2336 as a means of redressing Canada's restrictive policy and ensuring the continued viability of a strategic U.S. industry.

STATEMENT

Canadian executive policy requires that all uranium concentrates (yellow cake) be converted into uranium hexafluoride (UF_6) in Canada prior to export. The only converter in Canada is Eldorado Nuclear, Ltd., a subsidized Crown Corporation. This policy precludes all U.S. and foreign companies from competing for UF_6 conversion of Canadian source uranium. Conversion follows the mining and milling of uranium and immediately precedes the enrichment process, which is performed by the U.S. Department of Energy. Conversion is an essential step in the nuclear fuel cycle. The policy threatens the economic viability of the U.S. conversion industry.

The UF_6 conversion industry has five companies in the free world competing for business—Eldorado (Canada), Comurhex (France), British Nuclear Fuels Limited (United Kingdom), Kerr-McGee (United States), and Allied (United States). Of the five, only Allied and Kerr-McGee are neither state-owned nor state backed. Electric utilities, which purchase the uranium, had been able to select conversion on the basis of traditional free-market bidding. This condition continues in other major uranium producing areas of the world.

Although the Canadian policy was first introduced in 1975, it had no significant impact until 1983, because exceptions were routinely granted. During 1983, the Canadian Government began to enforce the policy rigidly and to refuse most requests for exceptions. This coincided with Canada's desire to add value to their raw materials. Late in 1983, the UF_6 conversion capacity of Eldorado Nuclear, Ltd., a Crown Corporation, was more than doubled to about 13,000 metric tons annually, with the addition of a new 9,000 metric ton conversion facility.

We understand that a compelling factor behind Canada's policy shift has been the expenditure of funds to expand Eldorado's conversion capacity. With a brand-new facility, we feel Eldorado should be able to compete over the long-term on a free-market basis for its own conversion business. However, by requiring that conversion be tied to the sale of uranium, Canada seems to be rewriting the rules it had espoused earlier about the need for free and open trade in uranium. These "new rules" are neither fair nor consistent. Canada has free access to U.S. markets and we feel the United States should have the same access for conversion of Canadian uranium.

In the past, Canada has opposed any restrictions on free trade in uranium. Specifically, in 1982, a bill was introduced in the Senate which would have limited the amount of foreign uranium which could be used in U.S. nuclear reactors. In response to strong objections from Canada, the Reagan administration lobbied against and defeated the bill.

Recently, U.S. utilities have been increasing the amount of uranium purchased from Canada, while decreasing the amount purchased in the United States. This is due to the availability of newly discovered high-grade Canadian uranium deposits which are being marketed aggressively. Under precent Canadian policy this means increasing imports of UF_6. As these imports from Canada continue to rise, coupled with declining U.S. production, the effect on the domestic conversion industry, which is essential for our nuclear power fuel supply cycle, will be crippling.

Since 1977, about 20 percent of the throughput of our UF_6 conversion facility in Metropolis, Illinois has been uranium of Canadian origin. The prospect of being denies the opportunity to convert Canadian uranium in the future will have a very severe impact on our business.

Because domestic uranium deposits are relatively low-grade compared to recently discovered high-grade Canadian ore, the U.S. uranium mining industry is already fighting for survival. Should the U.S. conversion industry not be available for conversion of U.S.-mined uranium, an additional economic penalty would accrue to the U.S. mining industry in the form of additional transportation costs to foreign conversion facilities. The failure of the domestic mining industry would not only cause political and economic problems, it would remove yet another link in the nuclear fuel cycle.

The national security of the United States depends in part on the ability to be self-sufficient in all aspects of nuclear technology. Having to depend on any other nation to provide a necessary step in this process potentially subjects our nuclear capability (naval fleet and weapons production) to an uncertainty unacceptable during a period of conflict.

Allied-Signal has made numerous efforts over the past few years to get the Canadian's to withdraw their policy. This has included direct meetings with Canadian government officials and support from Senators Bentsen, Bradley, Chafee, Danforth, Heinz, Mitchell and Moynihan in seeking to have first Prime Minister Turner and then Prime Minister Mulroney withdraw the policy. The U.S. State Department has raised the issue several times with the Canadians. It has been an agenda item during bilateral meetings led by Ambassador Kennedy and during meetings of the International Energy Agency. The office of the U.S.T.R. has discussed the problem with the Canadians on several occasions, including before the summit meeting between President Reagan and Prime Minister Mulroney. All these attempts to have the Canadian policy withdrawn and to return to a free-market condition have met with failure.

Allied-Signal strongly supports the passage of H.R. 2336 as a means of redressing Canada's restrictive policy on uranium upgrading and ensuring the viability of the U.S. conversion industry, which is essential to our security and energy interests.

Mr. PEASE [presiding]. Thank you very much, Mr. Bishop. We appreciate your testimony. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

My knowledge of this field is pretty slim. All I know is what the Government witness told us, and that was that if we were to pass the bill the United States would be subject to compensation and/or retaliation. And the second objection the administration has was that we were now engaged in negotiations for a free trade arrangement with the Canadians in which both governments had pledged to tear down barriers rather than to erect them.

Could you comment on those two administration objections, please?

Mr. BISHOP. Well, let me say that I understand the administration's position and we would like very much for them to be successful in their endeavors concerning free trade negotiations with the Canadians. However, our concern is very much an immediate concern. We are running today in this industry on the basis of long-term contracts.

Frankly, our suffering has been lessened by the fact that we are running on old contracts that were signed prior to the rigid enforcement of this Canadian policy. Our concern is that we cannot wait long enough perhaps for the administration to achieve success in these negotiations, and we feel very strongly that we need a more immediate remedy.

Mr. FRENZEL. My next question would be that I don't think I have ever seen a tariff bill drafted exactly this way. It is a very direct approach to the problem but it is effective until such time or as long as the country requires that uranium be converted or upgraded before export. It is an unusual approach.

Mr. Chairman, I thank the witness for his work. I see there are sponsors present who can shed more light on this than I can. I yield back my time.

Mr. PEASE. Mr. Schulze.

Mr. SCHULZE. I have no questions, Mr. Chairman.

Mr. PEASE. Mr. Vander Jagt?

Mr. VANDER JAGT. Thank you very much. I would like to thank my colleague, Mr. Frenzel, for welcoming Mr. Bishop of Allied Chemical here on my behalf. It was especially nice of my colleague to do that for me since he and his colleagues have been here all day long doing my work for me while I was elsewhere. So I am especially appreciative.

Not having been here when you gave your statement, I have read it. Let me summarize it for you and see if my conclusions are accurate. If they aren't, please feel free to correct me. The problem is that Canada, by regulation, has resulted in very protectionist action in that uranium that is mined can only be exported if it is processed, clearly a protectionist barrier. So you suggest a duty on processed uranium coming in here that would disappear the moment Canada stops its protectionist policy.

Mr. BISHOP. Precisely.

Mr. VANDER JAGT. Then I understand it well and I thank you very much for your appearance and your testimony.

Mr. BISHOP. Thank you, Congressman.

Mr. FRENZEL. I am still not understanding, and would the gentleman yield?

Mr. VANDER JAGT. I will be more than happy to yield.

Mr. FRENZEL. You put a duty on the processed uranium?

Mr. BISHOP. That is correct, sir.

Mr. FRENZEL. Obviously this would increase the price for you should you choose to buy it?

Mr. BISHOP. That is correct. Our company is not normally a purchaser of this product. It's purchased primarily by the electric utilities who have nuclear power programs.

Mr. FRENZEL. Can you tell us what the current status is? Those purchasers who buy it raw in the United States would be required under the Canadian regulation to buy it processed from Canada?

Mr. BISHOP. Yes, sir. Up until about 3 years ago the most common approach was for electric utilities with nuclear power programs to buy uranium concentrates or yellow cake and then they would independently request copetitive bids for the conversion or upgrading of that material to uranium hexafluoride. This is all we are asking be continued. We would like to continue to be able to compete freely for that conversion to uranium hexafluoride.

Mr. FRENZEL. Your company is an upgrader?

Mr. **Bishop**. That is correct, sir.

Mr. **Frenzel**. Under contract for the consumer?

Mr. **Bishop**. That is correct.

Mr. **Frenzel**. Who is a generator usually?

Mr. **Bishop**. Yes, sir.

Mr. **Frenzel**. OK. So the Canadian rules are cutting you out of the game.

Mr. **Bishop**. Absolutely

Mr. **Frenzel**. When did they start to cut you out of the game?

Mr. **Bishop**. This policy began to be rigidly enforced in late 1982, to the best of my knowledge. So it has been for the past 3 years.

Mr. **Frenzel**. What is keeping you alive in the game at the moment is the existing contracts with the consumers?

Mr. **Bishop**. That is correct.

Mr. **Frenzel**. At the moment. When they run out, then you are likely to be licked by the Canadian product absent the $3 per ton duty?

Mr. **Bishop**. Yes, sir. Our belief is that that duty——

Mr. **Frenzel**. Per pound, excuse me.

Mr. **Bishop** [continuing]. That per pound duty is in excess of this charge for conversion services of uranium to hexafluoride. Therefore, we feel that passage of this bill would likely result in the Canadian withdrawal of their restrictive trade policy.

Mr. **Frenzel**. Thank you, Mr. Chairman.

Mr. **Pease**. Thank you, Mr. Frenzel.

Mr. Bishop, do I understand correctly that there are two plants in the United States that convert yellow cake to hexafluoride?

Mr. **Bishop**. Yes, sir. That is correct.

Mr. **Pease**. You own one of them?

Mr. **Bishop**. Yes, sir.

Mr. **Pease**. What percentage of the market do you hold?

Mr. **Bishop**. There are five commercial conversion facilities throughout the world and we have an approximately 30 percent world market share. We have always viewed this business as a worldwide business.

Mr. **Pease**. Roughly, though, what percentage of the U.S. market would you have?

Mr. **Bishop**. It's very difficult to say. We have the largest share of any other converter. I can get you the proper response to that, but we have just never looked at those statistics in that manner.

Mr. **Pease**. I would appreciate it if you would do that.

Mr. **Bishop**. We certainly shall.

[The information follows:]

Allied-Signal Inc.,
Washington, DC, February 21, 1986.

Hon. Donald J. Pease,
Ways and Means Committee,
Longworth House Office Building,
Washington, DC.

Dear Congressman Pease: In the course of my testimony on HR2336 concerning the restrictive Canadian trade policy which took place on February 6, 1986 before your Committee, you asked me to advise you as to our domestic market share for UF_6 conversion.

Our study, based on last year's statistics, indicates that our share is approximately 50%.

I wish to again express my appreciation to you and the other members of the Committee for the opportunity to testify on this matter which is of great importance to our business area.

I certainly appreciate your kind support and interest, and look forward to a timely resolution of this trade issue with Canada.

Sincerely,

J. C. **Bishop**,
General Manager, Nuclear Activities,
Engineered Materials Sector.

Mr. **Pease**. Are you telling me that you can't buy uranium from Canada?

Mr. **Bishop**. At the present time, anyone who wishes to purchase uranium from Canada is required by this restrictive policy of the Canadians to purchase it only in its highest upgraded form, namely, UF_6. The problem is exacerbated because of these very rich deposits of uranium ore that are now being mined in Canada.

For example, during the past 5 years, uranium concentrates or yellow cake production in this country has declined to about 25 percent of what it was in 1980, whereas in Canada their production has increased to about 160 percent of what it was in 1980. So you can see how the problem is being compounded.

Mr. **Pease**. You maintain that the Canadians through this policy are trying to protect a processing plant in Canada?

Mr. **Bishop**. That is correct, sir.

Mr. **Pease**. One plant?

Mr. **Bishop**. They have one plant. It's Eldorado Nuclear, a crown corporation that we feel has been subsidized by the Canadian Government.

Mr. **Pease**. I am not sure that I know what the term crown corporation means. Does that mean it's owned by the government or chartered by the government or what?

Mr. **Bishop**. Well, a very simplistic explanation of my understanding of that term would mean that the company is operated much like a private company within the United States except that the only shareholder would be the Canadian Government.

Mr. **Pease**. I see.

If you can't buy yellow cake from Canada, where do you get your yellow cake that you process?

Mr. **Bishop**. Well, we still get material from within the United States even though that is declining year by year.

Mr. **Pease**. Is there a worldwide market for yellow cake?

Mr. **Bishop**. Yes, sir. There are other producers throughout the world. One of the new and more important producers is located in Australia, Northern Territory, in Australia.

Mr. **Pease**. What about your supply; do you get it mostly from U.S. producers or from overseas producers?

Mr. **Bishop**. No, sir, we get it from all over the world.

Mr. **Pease**. Is there a worldwide price for yellow cake?

Mr. **Bishop**. It's traded, I would say, as a commodity and the prices vary. Normally, I think utilities which buy the yellow cake will solicit proposals from producers from all over the world.

Mr. **Pease**. I see.

Mr. **Bishop**. The Canadians, by discovering these very high-grade deposits of uranium, have a substantial cost advantage and they are becoming much more important; in fact, dominant perhaps, in supply of uranium to the United States.

Mr. **Pease**. Well, the Canadians are shipping hexafluoride which—can the powerplants use hexafluoride directly or do they have to convert it?

Mr. **Bishop**. No, sir. Prior to using it, it has to be enriched, which is accomplished by the Department of Energy in their gaseous diffusion plants at the present time. Then following enrichment, it has to go through what is known as fuel fabrication.

Mr. **Pease**. Well, if you were to supply hexafluoride to a utility company, you would buy the yellow cake on the world market, process it and supply the hexafluoride. How do your costs and your prices compare with the Canadian price of hexafluoride coming across the border?

Mr. **Bishop**. Well, we do not normally buy uranium and process it and sell it. We perform a service for the utilities. Utilities normally buy the uranium and then we would sign a contract with the utility, a service agreement to convert whatever material they require over a period of years into uranium hexafluoride. We have no request at all for any protectionism in this matter. All we ask for is a right to compete on a free trade basis. We are willing to run whatever risk there is in the marketplace relative to being a cost-effective producer.

Mr. **Pease**. I think I am beginning to understand it now. Since you don't purchase yellow cake and then process it, you don't have the productive hexafluoride to sell?

Mr. **Bishop**. That is correct.

Mr. **Pease**. The Canadians do have it to sell; is that right?

Mr. **Bishop**. Yes, sir. The problem really may be simplified by giving you an example. In the past, say in 1981, if a utility which had a nuclear power program chooses to buy uranium concentrates from Canada, they could do so, and that material could be shipped to anywhere in the world to be converted into uranium hexafluoride where a capability existed. We were one of the companies that did compete on an economic basis for that business and we did so quite successfully. However, beginning in 1982 we were precluded from competition because of this restrictive policy by the Canadian Government.

Mr. **Pease**. So, essentially, what the Canadians are saying now is that if American powerplants buy yellow cake from Canadian producers it must be processed by Eldorado?

Mr. **Bishop**. Precisely that.

Mr. **Pease**. Fine.

If there are no more questions, Mr. Bishop, we appreciate your testimony.

Mr. **Frenzel**. May I ask one more?

Mr. **Pease**. Sure.

Mr. **Frenzel**. You indicate that as a crown corporation it's receiving subsidies. Are there capital subsidies?

Mr. **Bishop**. At one time in the past I recall the Canadian Government gave to Eldorado Nuclear Corp. the entire Canadian stockpile of uranium, and as such I would judge it to be a capital subsidy.

Mr. **Frenzel**. At that time did you know what the price was?

Mr. **Bishop**. There are trade publications that publish an approximate price for uranium, so we had an idea, yes.

Mr. **Frenzel**. It was generally thought in the business that that was a preferential arrangement?

Mr. **Bishop**. Yes, sir.

Mr. **Frenzel**. I yield my time.

Mr. **Pease**. Thank you again, Mr. Bishop. We appreciate your coming.

Mr. **Bishop**. Thank you. I appreciate the opportunity to testify.

Mr. **Pease**. We have no more witnesses scheduled this afternoon. Another bill that the committee has under consideration for which we have no witnesses today was H.R. 1004, relating to self-certification of automobiles. I have a statement which, without objection, I would submit for the record at this point on that bill.

[The statement follows:]

STATEMENT OF CONGRESSMAN DON J. PEASE

HOUSE WAYS AND MEANS SUBCOMMITTEE ON TRADE

FEBRUARY 6, 1986

Mr. Chairman, I am pleased to have an opportunity to testify today on HR 1004 and U.S. automobile trade with Japan. Trade in this sector very much reflects the tremendous imbalance in our overall trading relationship with Japan.

In the 1970s, American auto manufacturers were selling approximately 17,000 cars per year in Japan. During this period, Japanese car manufacturers sold around 1,400,000 cars per year in the U.S. Last year, a mere 2,000 American cars were sold in Japan, while some 2,300,000 Japanese cars were sold in the U.S. This represents roughly a $20 billion trade imbalance in the auto sector alone or 40% of the total $50 billion U.S. trade deficit with Japan.

The United States is the world's foremost automobile manufacturer. In 1985, we produced an estimated 7.7 million cars. How is it that the world's most prolific car producer sells virtually no cars in Japan, the world's second largest market?

For one, large American cars do not go over well in Japan because of the often cramped road conditions and the high premium placed by the Japanese consumer on fuel efficiency. As far as small cars are concerned, the Japanese have a decided quality and cost advantage over all of the major competition.

In addition, there is in Japan a two-tiered commodity tax levied on cars coming into the country. It is calculated as a function of engine size. Most American cars fall into the higher, 23% category. This tax hits American car manufacturers particularly hard. Unlike their European counterparts, they cannot offset it against value added taxes paid in the home country and rebated to them upon export.

General Motors estimates that elimination of the commodity tax would permit an average price cut of $3,469. For Ford, that estimate is closer to $4,200 per car. Chrysler believes that the commodity tax's elimination would increases sales by 20 percent.

As if these obstacles were not formidable enough, the Japanese for years have had a complex and time consuming procedure for certifying that foreign cars comply with Japanese safety standards.

By contrast, when a Japanese auto manufacturer ships a new model to the United States, U.S. law permits the manufacturer to self-certify that the vehicle complies with U.S. safety requirements, some of the toughest in the world. Under Section 114 of the National Traffic and Motor Safety Act of 1966, all foreign manufacturers have to do is affix a label or tag to the vehicle or equipment container indicating that the safety standards have been met. In this way, new models are not delayed in reaching the market. Cars goes directly to the sale lot and are marketed to the American consumer the next week. The U.S. Department of Transportation subsequently verifies a compliance statement submitted by the Japanese manufacturer.

In October 1981, after four years of talks on automobile standards-related trade issues, the U.S. government officially requested that the Ministry of Transportation (MOT) permit self-certification of safety standards compliance by foreign manufacturers. MOT indirectly rejected the U.S. request in April of 1982. Later that year, the Administrator of the National Highway Traffic Safety Administration (NHTSA) met with MOT regulators to explain the U.S regulatory system and to push for the acceptance of a similar system in Japan.

In May 1983, under pressure from the United States, Japan agreed to a revision of its safety certification system. These changes were intended to simplify the existing system rather than institute a new one based on the principle of self-certification.

These changes simplified Japan's regulatory system by requiring approval of only one vehicle (as opposed to three), reducing the amount of statistical information maintained by manufacturers, and accepting completion assembly inspection as a substitute for factory inspection.

General Motors tested a 1985 Cadillac in late 1984 under the new program. Its experience showed that the revised system cost $85 more per vehicle than the previous system. It concluded that the new system would be cost beneficial only if approval is sought for more than 514 vehicles of the same model type.

In another move, MOT announced in December 1984 a new policy of accepting test data from laboratories officially recognized by foreign governments. The U.S. government does not officially recognize laboratories that test vehicles, although both NHTSA and the EPA maintain lists of laboratories that they believe are capable of determining conformity with their requirements. As it turned out, this development was of little benefit to American companies, since all testing is conducted in their manufacturing facilities, which MOT does not find acceptable.

Despite these changes, as of first half of 1985, American cars were still taking on average 75 days for approval. The Japanese regulatory system continued to represent a significant barrier to the sale of American cars in Japan. While the Japanese procedure for testing and certifying automobiles did not appear to be designed to discriminate against the U.S. manufacturers, it did in the opinion of these companies inhibit trade.

In July 1985, Prime Minister Nakasone's Action Plan was unveiled. It mandated another round of improvements in the auto safety certification process. All of the details of this initiative are not yet available. However, a general outline of the new system has been disclosed.

The new system for cars exported to Japan in relatively small quantities is known as the Preferential Handling Procedure (PHP). It has been characterized by Japanese officials as "approximating self-certification". Under this system, manufacturers' safety test data will be accepted unconditionally and will require no further confirmatory testing by MOT. MOT officials will visit dealer facilities in Japan to verify that vehicles match documentation. Furthermore, up to 1000 units of each type of imported vehicle can be certified annually under the new system. Previously, preferential treatment for models imported in small quantities had been limited to 500 units per year.

Since total annual American car exports to Japan amount to only 2000, these changes were clearly designed with U.S. firms in mind. However, in view of past experience, American manufacturers are taking a wait and see attitude. They will wait to see the new procedures in operation before they pass judgement on how closely the procedures approximate self-certification.

I believe that this is the appropriate stance for Congress to take as well. For this reason, in my view there continues to be a need for legislation along the lines of my bill, HR 1004, and Representative Dingell's proposed amendment to HR 2248, the National Highway Safety Administration Authorization bill.

These bills use different approaches to accomplish the same goal: reciprocal treatment regarding auto safety certification. Regardless of the volume of trade involved, there is no reason why Japan's regulatory system should be permitted to inhibit U.S. exports, whether intentionally or not. Foreign unfair trading practices have become the focus of the debate on what to do about our colossal trade deficit. Here is one practice that we can ensure is eliminated. Accordingly, I strongly urge your support of HR 1004 and Congressman Dingell's amendment to HR 2248. Thank you.

Mr. Pease. The hearings will resume tomorrow at 9:30 to consider three ethanol bills, H.R. 1566, H.R. 1567, and H.R. 1720. The record on bills considered today will remain open until the close of business Thursday, February 13.

The hearing is concluded.

[Whereupon, at 3:45 p.m., the committee adjourned, to reconvene at 9:30 a.m., Friday, February 7, 1986.]

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CERTAIN TARIFF AND TRADE BILLS

FRIDAY, FEBRUARY 7, 1986

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen.

Today is another meeting of the Trade Subcommittee of the Ways and Means Committee. We will continue taking testimony on several tariff and trade bills.

Today's agenda is devoted to three ethanol bills, H.R. 1566, H.R. 1567, and H.R. 1720. Due to an extensive witness list, I am asking each witness to summarize his testimony within a 5-minute timeframe. Testimony from members and the private sector will be taken in the order listed in the agenda, which has been made available.

Our first panel includes distinguished Members of Congress. Mr. Michel, Mr. Leach, Mr. Daschle, and Mr. Durin. Good morning. Would you all come to the table. I am sorry that we were not able to get to this subject sooner. I know all these bills have been pending for some time, but, as you recall, last year was to be the year of the tax matters, and that is where we got stuck. I realize that you all have been petitioning for relief, and we will try to make rapid progress from here on out.

Mr. Michel, distinguished Republican leader of the Congress, we are happy to have you go first.

STATEMENT OF HON. ROBERT H. MICHEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. Michel. Thank you, Mr. Chairman, I appreciate the subcommittee holding the hearing. I will keep my remarks short, and submit a lengthier statement for the record.

Why do we need the legislation? Well, Congress has placed a high priority on the development of an ethanol industry, and we have provided tax credits and duties on imports in an effort to help the industry get off the ground. The results have been quite significant.

Most importantly, in view of the crisis in the farm economy is the amount of grain, primarily corn, which is used in ethanol production, 240 million bushels were used last year alone. Nationwide this represents approximatley 3 percent of our total production, but in Illinois it is considerably higher, roughly 12 percent.

Most significantly, in terms of our budget deficit problems, these sales in our country are reducing farm program costs by an estimated $650 million annually, thus reducing the deficit by a similar amount.

With our domestic ethanol industry now in an increasingly viable position, providing significant economic benefits to our Nation, it would be folly to allow it to be undermined through a flood of low-cost ethanol imports. We thought we had developed the means to prevent this from happening through the application of a 60-cent duty.

Unfortunately, the duty has not proven to be fool proof. Ingenious nations seeking to flood our markets have found ways to do so without payment of the duty. Last year, the 60-cent duty was paid on 51 million gallons of ethanol entering this country for fuel purposes, but some 70 million gallons came in duty free; in other words, 58 percent of the total imports were able to escape the payment of a duty which we thought was all-inclusive.

Brazil is the largest importer, it has the capacity to produce almost as much ethanol as we do, and, of course, at much lower cost. So if Brazil is allowed to import duty free, it could wipe out our domestic industry in very short order.

Let me briefly just cite several of the methods by which these countries have sought or are seeking to ship ethanol into the country without paying the prescribed duty.

One such method was to mix ethanol with another compound and have it avoid the duty by being declared an ethanol mixture. We were able to get the Customs Service to close that door last year, but H.R. 4094 goes a step further by writing the legislation in the law. That will prevent customs from reversing itself at any future date.

The Brazilians are mixing ethanol with another compound called benzenoid. Because benzenoid is on the preference list, it is allowed into this country duty free. The result is that ethanol, under the guise of benzenoid mixture, is being allowed into the country without payment of the duty. And our bill closes that loophole, imposes a duty on this mixture, as well as any similar mixtures.

I should point out here, Mr. Chairman, that the U.S. Trade Representative on Wednesday undertook a self-initiating emergency review to consider removing from the GSP list benzenoid and three other compounds which can be used in ethanol mixtures. This is only the second time that the U.S. Trade Representative has utilized this self-initiating procedure and indicates the urgency which our Trade Representative places in closing the loophole.

So I would certainly hope the commitee would give real serious consideration to tightening up what we perceive to be some gaping loopholes here. I know my colleagues feel just as strongly about this as I do, and I am happy to have this opportunity to express our views.

As I said, we will submit a complete statement for the record, Mr. Chairman.

Chairman GIBBONS. And the record will remain open to receive your statement.

Mr. MICHEL. Thank you.
[The prepared statement follows:]

STATEMENT OF HON. ROBERT H. MICHEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

I appreciate having this opportunity to testify today on behalf of legislation designed to deal with the problem of ethanol imports.

As you may know, Mr. Chairman, last week I introduced H.R. 4094, the Ethanol Fair Imports Act of 1986. The bill is designed to close all the loopholes we can think of which allow ethanol imports to enter this country duty-free. By treating the issue in a comprehensive fashion, it goes a step further than other bills which have previously been introduced.

Why do we need this legislation?

Congress has placed a high priority on the development of a viable domestic ethanol industry. We have provided excise tax exemptions, tax credits, and duties on imports in an effort to help the industry get off the ground.

The results have been significant. Domestic ethanol production has risen from less than 10 million gallons in 1978 to 620 million gallons in 1985. Over half of that amount, 330 million gallons, is produced in Central Illinois. When the ethanol is combined with gasoline at a 10 percent ethanol, 90 percent gasoline blend, the result is over 6 billion gallons of fuel, which represents some 7.2 percent of all gasoline sold in the United States last year. We estimate that the ethanol industry accounts for some 1500 jobs in Illinois, both directly and indirectly, so it is a major economic player in our state.

Most importantly, in view of the crisis in the farm economy, is the amount of grain, primarily corn, which is used in ethanol production. 240 million bushels were so used last year. Nationwide, this represents approximately 3 percent of total production, but in Illinois it is a much higher 12 percent.

Estimates are that these sales for ethanol have increased farm income by $870 million annually and have raised the price of corn by 10 cents a bushel. One of our ethanol companies estimates that its annual purchase of 24 million bushels represents the total corn production of some 2000 Central Illinois farm families.

Most significantly, in terms of our budget deficit problems, these sales are reducing farm program costs by an estimated $650 million annually, thus reducing the deficit by a similar amount.

With our domestic ethanol industry now in an increasingly viable position, providing significant economic benefits to our nation, it would be folly to allow it to be undermined through a flood of low cost imports. When Congress enacted the 60 cent per gallon duty on ethanol imports, we thought we had developed the means to prevent this from happening.

Unfortunately, the duty has not proven to be fool proof. Ingenious nations seeking to flood our markets have found ways to do so without payment of the duty. Last year the 60 cent duty was paid on 51 million gallons of ethanol entering this country for fuel purposes, but some 70 million gallons came in duty-free. In other words, 58 percent of the total imports were able to escape the payment of a duty which we thought was all-inclusive.

Brazil is by far the largest importer, and estimates are that it has the capacity to produce almost as much ethanol as we do, and of course, at a much lower cost. So if Brazil is allowed to import duty-free, it could wipe out our domestic industry in very short order.

Let me briefly cite several of the methods by which these nations have sought, or are seeking, to ship ethanol into this country without paying the prescribed duty.

One such method was to mix ethanol with another compound and have it avoid the duty by being declared an ethanol mixture. We were able to get the Customs Service to close that door last fall, but H.R. 4094 goes a step further by writing the regulation into law. That will prevent the Customs Service from reversing itself at any future date.

The Brazilians are now mixing ethanol with another compound called benzenoid. Because benzenoid is on the Generalized System of Preferences list, it is allowed into this country duty-free.

The result is that ethanol, under guise of a benzenoid mixture, is being allowed into this country without payment of the duty. My bill closes that loophole and imposes the duty on this mixture as well as any similar mixtures.

I should point out at this point that the U.S. Trade Representative on Wednesday undertook a self-initiating emergency review to consider removing from the GSP list benzenoid and three other compounds which can be used in ethanol mixtures. This is only the second time the USTR has utilized this self-initiating procedure, and indicates the urgency which the USTR places on closing this loophole.

This action is also noteworthy in that it indicates an intent by this Administration to move aggressively against unfair trade practices, as the President promised he would do.

Under current law, a product from a Caribbean nation is allowed into this country duty free is as little as 35 percent is added to the value of a product. Spain and other nations are shipping ethanol through Jamaica, where 35 percent is ostensibly being added to its value, and it is then coming into this country duty-free.

My understanding is that several CBI nations which undertake the total production of ethanol, such as Costa Rica and El Salvador, are strongly concerned that countries simply resorting to this dehydration process are allowed to take advantage of the duty-free provisions. They feel it is an abuse of the law, as do I.

Our insular possessions, such as the Virgin Islands, are also allowed under law to ship foreign products into this country duty-free, if as little as 30 percent is added to the value of the product. We understand that the Virgin Islands are gearing up to ship foreign ethanol into the United States under this guise.

H.R. 4094 closes both of these loopholes and allows ethanol to be imported duty-free only if it is 100 percent produced in our possessions or the Caribbean nations.

In conclusion, Mr. Chairman, H.R. 4094 represents a comprehensive effort to assist our domestic ethanol industry and our farmers in warding off unfair foreign competition. I hope the Committee will see fit to act on it at the earliest opportunity, perhaps as part of a more limited miscellaneous tariff bill or in connection with an overall trade bill. Time is of the essence.

I thank the Committee for its consideration.

Chairman GIBBONS. Next on our list this morning is Congressman Leach.

STATEMENT OF HON. JIM LEACH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. LEACH. Thank you, Mr. Chairman.

I have a lengthy statement and would request unanimous consent——

Chairman GIBBONS. Without objection, it will be entered in the record.

Mr. LEACH. Let me just say I am delighted to appear on this bipartisan panel and would just like to stress two points. I introduced with Senator Dole two bills earlier this fall to close the loophole related to the problem that Congressman Michel well described. Subsequently refining legislation has been submitted by Congressmen Michel and Durbin, and I am certainly, with one small exception, in strong support of those pieces of legislation.

The points I would like to raise expand on Congressman Michel's statement. One relates to the Caribbean Basin Initiative. There is a myth that we are trying to, in some fashion, deter development in that region. Actually it is precisely the reverse. Congressman Durbin and I had breakfast this morning with official representatives of the Governments of El Salvador and Panama. The representative of the Government of El Salvador is a son-in-law of President Duarte. They point out that allowing drying facilities in the region jeopardizes dramatically agricultural development in the Caribbean Basin Initiative because the real labor aspect is in production, not in the minimal investment involved in drying facilities.

To not close these loopholes, in effect, subverts the intent of Congress by extending geographically the Caribbean Basin Initiative to other parts of the world. One could quite dramatically point to a map of the world and say "Here is the Caribbean, here is Spain, here is Brazil, do Spain and Brazil reside within the Caribbean, or do they not?"

The point I would like to stress is that in Panama the official representative of the Government of Panama who came up here for the precise purpose of submitting the perspective of their Government before this committee is that they cannot go ahead with the investment that they would like to make if these drying facilities are allowed because they cannot compete on an economic basis with them.

I would also stress that in El Salvador, the El Salvadorian Government has committed $20 million to such facilities, they have a line of credit for another $20 million for the private sector. This is a substantial investment. El Salvador and Panama are two of the most strategically important countries in the hemisphere at this time, and we are jeopardizing their economic development by not closing these loopholes.

In addition, I would underscore again that a drying facility is very nonlabor intensive. The particular facility that is being referenced in Jamaica is alleged to employ 40 people. Experts in this country have told me that type of facility in the United States would operate with four people. Experts have told me that whereas it has been stated that it is a $20 billion investment in Jamaica, to build such a facility in the United States is only $3 to $4 million and almost certainly less expensive in a part of the region such as the Caribbean Basin to develop.

Experts have also informed me in terms of the fact of whether or not Congress should move on to that particular facility that almost certainly the investment has been recovered several times over in the brief period in which it has been allowed to operate. The only point I would disagree with my distinguished colleague from Illinois who has submitted legislation that is superior to that which I have submitted is its grandfathering provision for this facility.

I think with Congress, the burden of proof should always be on the exceptions, and I don't think the burden of proof exists in this instance. When you make an exception, you always put an unfairness into the code, and I don't think that we ought to be grandfathering in facilities that, in effect, milk the Tax Code of the United States, and I would urge the committee to seriously consider making that refining adjustment in Congressman Michel's legislation.

Finally, let me just stress in terms of American agriculture, we are at a crossroads in this country. We can pursue a path of expensive governmental initiatives to restrain production, or we can attempt to develop new uses for American crops. Ethanol is the single greatest potential new use for an American crop in the next decade that anybody knows about, and to deny that potential development, to deny American markets in our backyards to our farmers, I think is simply nuts.

Now, granted there is an aspect of all legislation which centers around tariffs that is perhaps philosophically imperfect. I think the modest protection provided involved for the American farmer at this time is a very powerful case that could be made before this Congress as a public body.

So I would urge the subcommittee give serious consideration to all of the legislation in this area. I think, frankly, Congressman Michel's bill is all the final piece that pulls all of the parts together, with the single exception of the grandfathering provision, I would hope it receives sympathetic consideration at this time.

Thank you, Mr. Chairman.

Chairman Gibbons. Thank you, sir.

[The prepared statement follows:]

Statement of Hon. Jim Leach, a Representative in Congress From the State of Iowa

Mr. Chairman, thank you for the opportunity to appear before you this morning on behalf of H.R. 1566 and H.R. 1567. I will keep my comments brief, and have a statement I ask be inserted in the record of the hearing at this point.

None of us need to be reminded of the severe economic dislocations the oil embargoes of the seventies caused. To its credit, Congress did not sit idly by and let our nation's energy policy be dictated by the Middle East. Instead, through tax incentives which encouraged conservation and the development of new energy sources, Congress took the lead in making our country less energy dependent. The current breakdown of OPEC and the resulting drop in world oil prices are the dividends of this effort.

One of the more symbolic of Congress's actions in this area was the imposition of a 60-cent-per-gallon tariff on ethanol imports to protect the domestic ethanol industry from predatory and highly subsidized foreign competitors.

Unfortunately, the commitment to establish a viable ethanol industry is being undermined, not by a change of Congressional policy, but by importers who are exploiting loopholes in other provisions of our trade laws.

Importers of Brazilian ethanol, for example, have avoided paying the 60 cent tariff by transshipping ethanol through Caribbean countries, and in the process have thwarted both Congress's commitment to the ethanol industry and its commitment to the Caribbean region to encourage substantive regional economic development.

As you know, the Caribbean Basin Economic Recovery Act authorizes duty-free treatment of articles imported from beneficiary Caribbean countries. By distilling or denaturing Brazilian ethanol within a CBI country, current law allows this ethanol to come into the United States duty-free—even though such a process employs only a handful of people and represents a deminimis capital investment in the Caribbean region.

Approximately, 15 million gallons of ethanol were imported duty-free through this loophole in 1985, costing the Treasury $94 million dollars in tariff revenues, the domestic ethanol industry $225 million in sales and the American corn farmer 6.2 million bushels in demand for his crop.

In addition, there has been a substantial cost to the Caribbean Basin countries for inefficient investments in distilling plants have benefitted non-CBI agricultural producers to the disadvantage of CBI farmers.

This harm which the exploitation of this loophole is doing the Caribbean Basin countries was emphasized during a meeting I had this morning with Carlos Escamelia, the son-in-law of President Duarte and head of El Salvador's ethanol industry. Mr. Escamelia stressed how transshipment schemes which allow Brazilian ethanol, for instance, to enter the United States duty-free undercut the efforts of countries like El Salvador to develop their agricultural economies and domestic ethanol industries.

Far from being anti-CBI, as some critics have intimated, action to close current loopholes in law and regulations is pro-CBI. It is also pro the American farmer.

H.R. 1567 amends the Caribbean Basin Economic Recovery Act to provide that ethanol produced in a non-CBI country and then transshipped to a CBI country to be distilled or denatured would not qualify for the duty-free treatment. Ethanol produced from Caribbean plants from crops, for instance, grown in Caribbean countries would continue to be eligible for duty-free shipment to the United States.

Again, I would stress that the intent of this legislation is not to undercut the Caribbean Basin Initiative, but instead to bolster it. The primary beneficiaries of the ethanol market should be American and CBI producers, not international refiners. To the extent that rules are slanted to advance the interests of producers from non-

CBI countries, the CBI becomes artificially extended beyond Congressional intent and, in the process, eviscerated.

The other bill I have introduced, HR 1566, would amend the tariff schedule to ensure that mixtures containing ethanol suitable for fuel uses are subject to the 60-cent-per-gallon tariff as intended by Congress. Furthermore, the bill would alter the procedure under which the current duty is assessed. The new procedure would require that the duty be assessed immediately upon entry of the imported ethanol.

Since H.R. 1566 was introduced, the customs service has to some degree closed these two loopholes administratively. Under a rule issued in August, ethanol blended with gasoline additives is now assessed the 60 cent tariff. Customs and the domestic ethanol industry, however, would still welcome legislation clarifying this issue.

Last fall, Customs also ruled that importers must have proof that the ethanol being imported will be used for industrial purposes in order to escape the 60 cent duty. Present law only imposes the tariff on ethanol used as fuel. Ethanol used for industrial purposes is exempt from the tariff. Before Customs new administrative ruling, importers had three years to declare whether ethanol was used for industrial or fuel use. If at the end of three years the product was used as fuel, the tariff would be assessed.

The delay in collecting the tariff amounted to a three year, interest free loan from the U.S. government to traders and marketers of fuel ethanol. Furthermore, it opened the possibility for individuals to abuse the system by setting up "dummy" corporations to import ethyl alcohol for industrial use, sell it for fuel use, then dissolve just before the three year end use reporting and duty deadline. Under HR 1566, those legitimately bringing in ethanol for industrial use would not be penalized; if they can document that the alcohol will be used industrially, the 60 cent duty would be reimbursed.

The benefits the domestic ethanol industry provides cannot be overstated, especially to the agricultural community which is struggling to find new markets for its surplus crops. In Iowa alone, the domestic ethanol industry provides a $135 million annual windfall. No new industry is potentially more important to our state.

In a fundamental way American agriculture is at a crossroads; expensive governmental approaches can be taken to reduce production or new uses for American crops can be developed. The ethanol issue symbolizes the dilemma policy makers confront. The greatest agricultural country in the history of the world can play patsy to subsidized foreign competition; or the American farmer can be allowed access to his own market in his own back yard. While admittedly an imperfect philosophical approach, I believe the national interest demands prudential concern for this modest protection of the American family farmer.

Since the introduction of H.R. 1566 and H.R. 1567, ethanol importers have found still more loopholes to circumvent the 60 cent tariff. This issue is a bit like squeezing a sponge. As you squeeze in one place, it expands in another. It is my understanding that Senator Dole and Congressman Michel are working on refinement of these two legislative approaches based upon the new issues that have arisen. These refinements are welcome and I hope the committee gives the most serious consideration to this modified legislative agenda.

Again, thank you for the opportunity to appear before you.

Chairman Gibbons. Tom.

STATEMENT OF HON. THOMAS A. DASCHLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Mr. Daschle. Thank you. I can't emphasize enough the point made by my colleague from Iowa. In agriculture right now, we are at a crossroads. The comparison which comes to mind is General Motors, Ford, or Chrysler after World War II facing a new era, facing the prospect of a market that would be limited, but continuing to produce automobiles as they did during the pre-World War II era.

Farmers have to break out of this mindset, they have to develop new markets. I think they have a golden opportunity to be not only the producers of feed and fiber, but fuel as well. As Mr. Leach said, this year we will be paying our farmers in the vicinity of $6 to $8 billion not to produce on their land. At the same time, the ethanol industry gives them a golden opportunity to not set-aside land and be nonproductive, but actually to grow crops and enhance their income.

Just last year, the domestic ethanol industry added $800 million to farm income and reduced Federal outlays for farm price support programs by more than $150 million. These facilities, in turn, produced enough fuel ethanol to displace over $600 million worth of imported oil and meet a sizable portion of the octane gap caused by the EPA's lead phase-out program.

I am a cosponsor of H.R. 1720, but would endorse any one of my colleagues bills. As Mr. Leach said, I think Mr. Michel's proposals have considerable merit.

I am a strong supporter of the Durbin proposal for one reason. There are a lot of loopholes in our trade laws we need to be concerned about. However, if there is one loophole we can knock out of the ball park, if there is one we need to impress upon this committee the importance of changing, it is the CBI exemption. With what limited time I have, I want to address that issue.

The intent of the CBI exemption is a good one. I do not question its value. However, under the exemption, there has been a great deal of abuse. Specifically the U.S. Customs Service has ruled that fuel ethanol produced in Brazil, Spain, or other non-Caribbean Basin countries and then upgraded from 190 to 200 proof through a distillation procedure in a CBI country qualifies for the duty-free treatment. This decision, is the problem. It is contrary to the intent of Congress and the CBERA statute.

All they are doing is bringing non-CBI ethanol into a CBI country, dehydrating it by 5 percent, and exporting the product to the United States with all of the rights and privileges and the duty-free status allowed product actually produced right there. This is the problem; this is the concern that we have as we look to close the loophole that is being abused today.

The intent of our legislation is not to prohibit duty-free treatment for ethanol which is a product of the CBI beneficiary country. Its effect will not be to discourage economic development in the Caribbean Basin. It will be just the opposite—to remove obstacles to capital investment in the development of grassroots ethanol facilities in these CBI countries.

As such, it is clearly consistent with our congressional intent. Duty-free imports of truly native Caribbean ethanol under the law are not opposed by the domestic ethanol industry. However, if subsidized ethanol from other sources is allowed to be imported into the Caribbean Basin, converted into anhydrous fuel ethanol and then exported duty free to to the United States, what we see is substantial damage to both indigenous Caribbean Basin development and the U.S. ethanol industry as a result of the unfair advantage enjoyed by the subsidized producer.

This transshipping scheme is really the issue that I feel must most be impressed upon the committee. Closing that loophole would do more than virtually anything else we do in this legislation to provide fair treatment of ethanol imported into the United States and allow CBI nations to reap the benefits envisioned by the CBERA.

So I commend the committee for considering the Durbin, Leach, and Michel bills today and for holding this hearing. I hope very sincerely that in the near future we can eliminate the loopholes which provide the marketers of non-CBI ethanol an unfair advantage over CBI production and the domestic industry in the U.S. market. Such action will restore competitive opportunities in the domestic ethanol market and, most importantly, from a South Dakota perspective, provide American farmers with new markets and inject a vitality into American agriculture they haven't seen for many years.

Chairman GIBBONS. Thank you.

[The prepared statement follows:]

STATEMENT OF HON. THOMAS A. DASCHLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Mr. Chairman, I want to thank you for the opportunity to appear before this distinguished panel to address an issue which is of great concern to me and to many residents of South Dakota—the existence of loopholes in United States trade law which allow ethanol imports to evade the U.S. import duties normally levied against such products.

I also want to thank the Subcommittee for taking the time to schedule a separate day of testimony on this issue. I commend the panel for making such a thorough effort to ascertain the facts about the impact of these loopholes on both U.S. domestic interests and on the integrity of the Caribbean Basin Economic Recovery Act (CBERA).

Six years ago, when Congress enacted short-term tax incentives to encourage the production and use of fuel ethanol from renewable resources, the dual objectives of the fuel ethanol program were to reduce our dependence on foreign sources of energy and to provide a new market for American farm products. This program has proven highly successful.

In this relatively short period of time, the domestic fuel ethanol industry has produced a significant liquid fuel alternative, a growing market for U.S. feedgrains, particularly corn, and an economically viable and environmentally benign replacement for lead as an octane enhancer in gasoline. In 1985 alone, nearly 65 commercial fuel ethanol facilities consumed the equivalent of 240 million bushels of farm crops, thereby boosting the price of corn by 9.9 cents per bushel, adding more than $800 million to farm income and reducing federal outlays for farm price support programs by $150 million. These facilities, in turn, produced enough fuel ethanol to displace over $600 million worth of imported oil and meet a sizable portion of the "octane gap" which has been caused by EPA's lead phase-out program.

Clearly, our country has reaped substantial benefits from its investment in the domestic fuel ethanol industry. Yet, that industry now faces an unanticipated threat from foreign competitors which could retard the realization of its full promise.

As a representative of a farm state, I am especially familiar with the potential which fuel ethanol holds for American agriculture. American farmers, caught in the vise of declining prices and restrictive credit, need new markets for their product. American agriculture is the most productive sector of our economy. We should be encouraging new outlets for their production, not undercutting them.

The threat to the domestic fuel ethanol industry is presented by certain marketers and traders who are utilizing loopholes in U.S. trade law to avoid paying full duty on ethyl alcohol imported for fuel use. These imports, which are certain to escalate without corrective action by Congress, not only unfairly impair the growth of the domestic fuel ethanol industry, they also cost the U.S. Treasury millions of dollars in foregone revenues.

Item 901.50 of the Tariff Schedules of the U.S. (TSUS) imposes a 60 cents per gallon duty on imports of anhydrous fuel ethanol. This duty was established to compensate for the federal excise tax exemption currently granted to gasoline blended with anhydrous fuel ethanol. Since the blended gasoline tax exemption is 6 cents per gallon and gasoline is blended with anhydrous fuel ethanol in a 10 to 1 ratio, anhydrous fuel ethanol enjoys an effective tax advantage of 60 cents per gallon. The 60-cent duty on imports is thus designed to offset foreign government subsidies of foreign ethanol producers and promote domestic production in the U.S.

Some importers have been utilizing at least three loopholes in trade law to circumvent this duty—the importation of fuel grade ethanol as industrial ethanol; the importation of ethanol mixed with gasoline or other compounds; and the importation of fuel grade ethanol from non-Caribbean Basin countries under the terms of CBERA. Last March, I joined with Mr. Durbin and other members of the House in introducing legislation (H.R. 1720) which addresses these loopholes.

H.R. 1720 would subject all imported ethyl alcohol to the 60-cent duty at the point of entry into the United States; require that the existing 60-cent duty on ethanol imported as a fuel or for fuel purposes also apply to ethanol imported as a mixture with gasoline and other compounds; and clarify the eligibility criteria for the importation of ethanol into the U.S. duty-free under the CBI statute. By closing these loopholes, it supports the intent of Congress when it established the tariffs on imported ethanol for blending with fuel and the original intent of Congress when it established the Caribbean Basin Initiative to enhance economic development in that region.

I would like to take a moment to elaborate on these three loopholes.

INDUSTRIAL USAGE

Current regulations allow an importer to avoid paying the 60-cent tariff on fuel ethanol by initially designating the ethanol as being intended for industrial use. Should that ethanol later be used as fuel, the importer has up to three years in which to pay the 60-cent duty with no interest or penalty. This amounts to a three-year interest-free loan to ethanol traders by the federal government.

Last September, the U.S. Customs Service acknowledged that some importers were circumventing tariff requirements by declaring ethyl alcohol imports, which were ultimately destined for fuel use, as industrial. They subsequently directed Customs Service officials to inquire of each importer of ethyl alcohol the purpose of importation at the point of entry into the country. If it is claimed that the product is not destined for fuel use, a declaration to that effect must be executed by the importer. I urge the Committee to assess the implementation of this program to determine if further action is required.

MIXTURES

Ethanol imported as a fuel or for fuel purposes is not only subject to duty under item 427.50 of the Tariff Schedule of the U.S., but also to an added duty of 60 cents per gallon under item 901.50 TSUS. However, ethanol imported as a mixture with gasoline, or hydrocarbons such as toluene, are not subject to this additional duty.

Some traders are currently avoiding the tariff by mixing foreign ethanol with gasoline and other compounds and then exporting it to the U.S. as a motor fuel or other blending components. Current tariff Schedule provisions indicate that the duty on such mixtures could be as low as 1.25 cents per gallon.

This practice is a clear exploitation of congressional intent by traders and marketers who seek to circumvent the 60-cent duty on imported ethanol. H.R. 1720 would close this loophole by requiring the 60-cent duty under item 901.50 TSUS to apply to ethanol imported as a mixture.

CBI EXEMPTION

Under the terms of the Caribbean Basin Economic Recovery Act (CBERA), ethanol produced in a CBI country and imported directly into the U.S. from that country is eligible for duty-free treatment. The CBERA set strict country of origin criteria to determine eligibility for duty-free treatment under the CBI program. These rules require that ethyl alcohol from non-CBI countries must undergo "substantial transformation" in a CBI country in order to be considered a product of that country. Their intent, as the Ways and Means Committee points out in its report on H.R. 3838, is "to discourage the establishment of simple pass-through operations in CBI countries."

Unfortunately, this intent has not been fulfilled in practice. In the past year, a series of events has demonstrated the need for further clarification of the substantial transformation criteria.

Under the CBERA as interpreted by the U.S. Customs Service, ethyl alcohol and ethyl alcohol mixtures which originate in non-CBI countries can be upgraded in CBI to fuel ethanol quality and then imported into the U.S. duty-free. Specifically, the U.S. Customs Service has ruled that fuel ethanol produced in Brazil, Spain or other non-Caribbean Basin countries and later upgraded from 190 proof to 200 proof through a simple distillation procedure in Caribbean Basin countries qualifies for duty-free treatment under CBI.

This dehydration process amounts to little more than the laundering of the product for the purpose of circumventing the U.S. tariff. It neither adds substantial value to the hydrated product nor constitutes a significant transformation of the product. Thus, it should not qualify for duty-free status. Furthermore, in direct contradiction to the intent of CBERA, simple distillation impedes the emergence of legitimate Caribbean Basin production of fuel ethanol.

H.R. 1720 would clarify the eligibility criteria for the importation of ethanol into the U.S. duty-free under CBERA by excluding from tariff-free treatment under CBERA ethyl alcohol used for fuel which utilizes the dehydration process only. It would not exclude the more capital and labor intensive processes of saccrification and fermentation in a beneficiary country.

The intent of H.R. 1720 is not to disallow duty-free treatment for ethanol that is a product of a CBERA beneficiary country. Its effect will not be to discourage economic development in CBERA beneficiary countries but rather to remove obstacles to capital investment in and development of grassroots ethanol facilities in those countries. As such, it is clearly consistent with the congressional intent underlying the CBERA.

Duty-free imports of truly native Caribbean Basin ethanol under that CBERA are not opposed by the domestic industry, If, however, subsidized ethanol from other sources is imported into the Caribbean Basin, converted into anhydrous fuel ethanol and then imported duty-free into the U.S., substantial damage may be suffered by both the legitimate Caribbean Basin and U.S. ethanol industries as a result of the unfair advantage enjoyed by the subsidized importer. This transshipping scheme should be stopped.

I commend the Ways and Means Committee for their interest in clarifying this issue. I share the Committee's view, as stated in their report on H.R. 3838, that the azeotropic distillation process "should be reexamined because it does not represent the real economic investment in the Caribbean region that was envisioned by the committee in establishing the CBI program." I also agree with the Committee that "allowing [this] process to qualify the alcohol for duty-free entry may actually be retarding economic development in the region by discouraging others from establishing full fermentation operations in the Caribbean." I hope that the Committee will move expeditiously to close this loophole.

CONCLUSION

Mr. Chairman, my intent in cosponsoring H.R. 1720 and in appearing before this panel today is not to advocate further restrictions on international trade or to undermine the Caribbean Basin Initiative. It is simply to point out to the Subcommittee how three loopholes in trade law violate congressional intent and the spirit of the law and undermine the domestic ethanol industry, the American farmer and the Caribbean Basin countries the CBERA is designed to help.

I urge the Subcommittee to seriously consider H.R. 1720 and close the loophole it addresses.

Thank you.

Chairman GIBBONS. Mr. Durbin, you are next.

STATEMENT OF HON. RICHARD J. DURBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. DURBIN. Thank you very much, Mr. Chairman.

I would like to join my colleagues in submitting my testimony for the record.

Chairman GIBBONS. It will be accepted.

Mr. DURBIN. We have a chart here before the committee for your consideration. It shows the growth of the American fuel ethanol industry over the last several years. In fact, last year was one of the most outstanding years on record, with a 32-percent increase in the domestic production of ethanol. I think it dramatizes how important, how productive and how promising this industry is for the U.S. economy.

Mr. Chairman, I have to tell you, quite candidly, I live in a part of the world where times are not as good as we would like to see them. There are people out of work, farmers losing their farms, and many asking questions of their Congressmen. They are frustrated, as I am, when they consider this issue.

Here we have a farm crisis which threatens farms all across America, and we find our own trade practices making it worse. We are allowing people to send ethanol into the U.S. duty free and to make substantial profits at the expense of American farmers. When we consider the fact, as the statistics have indicated, that the domestic fuel ethanol industry adds 10 cents a bushel to the value of corn, when we diminish that industry, we diminish the amount the farmer receives.

If there was ever a time in America's modern history we should be more sensitive to the impact of these decisions on the American farmer, I can't remember it. This is the time when we have to zero in and answer the very difficult question of why we aren't doing more.

Second, one obvious preoccupation in Washington is the budget deficit. We go from day-to-day answering questions about the impact of Gramm-Rudman and what kind of sacrifices we will ask of America in order to reduce the budget deficit, but the fact is the current loopholes in the law allow foreign countries and their exporters to avoid paying duties into the Federal Treasury at the expense of the American taxpayer.

In addition, if we decreased the demand for American farm products for ethanol, we increase the cost of America's farm programs. Yesterday the Congress considered on the floor a measure that was originally requested by the administration in the amount of $8 billion, a supplemental appropriation for the Commodity Credit Corporation. It was reduced on the floor, and it passsed by a voice vote. If we are going to be facing the probability of increased cost in our agriculture programs, we have to step back and say, is there a way to improve the situation? There certainly is, by encouraging the domestic ethanol industry and more demand for our farm products.

Another issue which hits us in the pocketbook Mr. Chairman, is jobs. Americans are sensitive to the fact our trade deficit is the worst it has ever been in the history of our Nation. By allowing the loopholes that we are addressing today with this legislation, we are creating jobs in Brazil, we are creating jobs in other countries, but at the expense of Americans. If we are going to stand back and watch the domestic ethanol industry die and American jobs lost, I am afraid we will be hard pressed to justify it in terms of the fact we didn't have time to close this loophole.

Finally, let me say that this committee and the full committee, in its action on the Caribbean Basin Initiative, made a commitment which the American people can support that we will really try to encourage the growth of the indigenous economy in the Caribbean nations. And yet we find by the existence of this loophole which has been encouraged by our own trade representatives and Customs Service, we are allowing duty-free ethanol to come into the United States at great profit to the exporters, but with little or no benefit to the economy of the Caribbean nations.

H.R. 1720 is a bill which I introduced in March 1985. It is a bill which now has many cosponsors, and I want to congratulate my colleague, Jim Leach, who joined forces with me early in a joint effort to pass this legislation, Congressman Bob Michel, my neighbor to the north, and Congressman Tom Daschle. I would ask the committee to seriously consider this legislation.

I brought another chart before the committee today which demonstrates how important ethanol is to our farming areas in terms of the number of bushels of corn which are dedicated to ethanol production. It is very critical to us in our part of the country.

I would also indicate to the chairman that our interest in this legislation goes beyond Washington, beyond Illinois, and beyond the United States. As Congressman Leach indicated this morning, we had breakfast with representatives of the Governments of El Salvador and Panama who made long journies to be with us today. Their message is simple, if we believe in CBI, if we want to create jobs in CBI countries, we have to close the CBI loophole.

What they are attempting to do in their countries is to build and maintain full fermentation and distillation facilities. They will continue to take their feedstock from the country, will convert it into full-grade alcohol and ship it to the United States under CBI as Congress intended. If the loophole remains, there will be an increase in the number of countries building distillation facilities in CBI nations, dragging in feedstocks from all over the world, taking it through a distillation process to which is the very last stage of production—employing very few people in Caribbean countries and still reaping the same benefit.

If we allow that loophole to exist, I think we will find that those CBI countries trying to build a totally indigenous ethanol industry will lose heart and give up in this effort. We will have created exactly the opposite impact we would have wanted to with the CBI legislation.

I have brought with me today statements by representatives of these two Governments, Carlos Escamilla from El Salvador, and Manuel Cabarcos from the Government of Panama. I understand the committee has certain rules relative to testimony from people other than American citizens. I will only present here statements for the committee to consider whether they can be made part of the record.

Chairman GIBBONS. We will certainly consider it. Without objection, when we get to it, we will put it in. We would like to look at it first.

[The statements appear in the record at the conclusion of the hearing.]

Mr. DURBIN. I want to urge this subcommittee and the full committee to take prompt action on this legislation. I know the committee is considering trade legislation that would address many topics. There is a really urgent nature to this legislation and what we are attempting to do. There are jobs at stake here. There is an expense to our Treasury which cannot be calculated at the moment, and I think what also is at stake is the integrity of the Caribbean Initiative.

If the committee moves quickly to close these loopholes and make it clear we are going to stand behind CBI, we will send a strong message that the United States is in business to do business with people who are going to deal with us fairly.

I hope the committee will take that recommendation under consideration and can consider moving this legislation to markup at the earliest possible time.

I also want to commend the chairman and members of the subcommittee for giving us this prompt hearing.

[The prepared statement follows:]

Statement of Hon. Richard J. Durbin, a Representative in Congress From the State of Illinois

BACKGROUND

Congress established incentives to create a domestic ethanol industry six years ago. The purpose was to enhance U.S. energy independence by developing a renewable energy technology and create new markets for American agricultural projects. The industry has responded to these incentives dramatically:

1. Domestic production has risen 3,795% between 1979 and 1985.
2. In 1985, the domestic industry consumed 240 million bushels of corn which: raised corn prices corn by 9.9 cents per bushel; boosted agricultural income by $800 million; and reduced federal farm price support outlays by $150 million.
3. Energy security is enhanced by displacing over one billion gallons of crude oil imports.

These enormous benefits generated by our growing domestic ethanol industry are threatened by unfair imports of Brazilian and Spanish ethanol.

THE NATURE OF THE THREAT

There are three loopholes in U.S. trade law that currently permit importers of foreign ethanol to evade a Congressionally mandated 60 cent per gallon duty. Traders and marketers can evade the 60 cent duty by:

1. importing fuel ethanol, claiming it is for industrial use;
2. importing fuel ethanol blended with gasoline and other compounds such as toluene, xylene, benzene and ethylbenzene;
3. and shipping hydrous ethanol to a CBI beneficiary country, subjecting it to a simple distillation process and importing anhydrous ethanol to the U.S. duty-free under the terms of the Caribbean Basin Economic Recovery Act (CBERA).

PURPOSE OF H.R. 1720

My bill would close all three loopholes by amending the Tariff Schedules of the United States and the CBERA, so as to apply the 60 cent duty to 1) all ethanol imports at point of entry (the duty to be reimbursed with proof that the product will be used industrially); 2) all mixtures of ethanol with gasoline and other compounds and; 3) all imported ethanol from CBI countries that have merely been subjected to simple distillation.

The bill does not levy the duty on ethanol produced indigenously in CBI countries. The bill restores the integrity of CBI by creating incentives for the development of full-scale ethanol facilities which would generate thousands of jobs, utilize CBI feedstock and generate needed economic benefits for beneficiary countries.

THE TESTIMONY OF RICHARD J. DURBIN

BEFORE THE HOUSE

COMMITTEE ON WAYS AND MEANS TRADE SUBCOMMITTEE

February 7, 1985

I wish to thank the Subcommittee for the opportunity to testify this morning on HR 1720. I also appreciate the Chairman's timely scheduling of a hearing on the ethanol trade bills. As my testimony will illustrate, time is of the essence in this matter.

My bill closes three loopholes in U.S. trade law that currently permit importers of foreign ethanol to evade a Congressionally mandated 60 cent per gallon duty. The duty was imposed to offset the 6 cent per gallon federal excise tax exemption for domestic ethanol producers. Very simply, these imports threaten the future of a promising domestic ethanol industry, undercut an important new market for American farmers, and could drain millions of dollars from the U.S. Treasury in forfeited duties, increased farm subsidies, and decreased tax revenues. Of equal significance, if these practices are continued, the integrity of the Caribbean Basin Initiative (CBI) could be severely compromised.

There is no question about the need for swift passage of HR 1720. Since I introduced my bill in March of 1985, certain marketers and traders have relentlessly sought to exploit U.S. trade law in pursuit of enormous profits. As a result, at least 65 million gallons of ethanol have entered the United States free of the tariff.

Regrettably, the Administration has responded reluctantly to Congressional requests to address these trade problems administratively. This indifference is symptomatic of a faulty trade policy that often seems to cater more to our trading partners than to American interests, and that contributes to our record $148.5 billion trade deficit.

It is, therefore, no surprise that there are six — and soon to be eight — bipartisan bills in both houses of Congress that would close these loopholes. I welcome all of these measures and look forward to working with the sponsors to develop the most effective legislative solution to this trade problem. This solution must address the needs of the domestic industry, the American farmer, and promotes economic development in the Caribbean Basin countries.

I am sure that all the witnesses hear today would agree with the assertion that America has invested well in promoting ethanol as a renewable fuel. The domestic ethanol industry has responded dramatically to the incentives Congress established several years ago. There are now 65 operating ethanol facilities across the nation. Twenty more will be operational with the next several months. The industry has had an important ripple effect, particularly in economically depressed regions in the Midwest. In Decatur, Illinois, a city in my district still experiencing double-digit unemployment, ethanol production has become one of the city's largest industries. It provides much needed jobs, tax revenues, and a growing market for surplus corn.

Domestic production since 1979 has risen 3,795 percent, from 20 to 759 million gallons. The Environmental Protection Agency's ordered reduction of lead in gasoline has created an octane gap such that demand for ethanol, a natural octane enhancer, is projected to increase significantly during the next several years. Recognizing the value of promoting the industry, the House reaffirmed its support for the industry just last December when it passed the Tax Reform bill which retained the 6 cent per gallon federal excise tax exemption for gasoline blended with ethanol.

The agricultural benefits of a strong ethanol industry are obvious. In 1985, US ethanol production consumed 240 million bushels of corn, a increase of 232 million over 1979. This new market demand translated into a $800 million boost in agricultural income, and a $150 million reduction in federal outlays for farm price support programs. Further, a recent study estimated that the increased demand for corn boosted the per bushel price by 9.9 cents. In an era when U.S. agricultural exports are declining, and the Administration is seeking over $20 billion in commodity credit and related programs, it would seem only logical to fight to preserve new markets for our farmers.

Congress first created incentives to develop an ethanol industry in the Energy Tax Act of 1978. Dramatic escalation of imported crude oil prices in the 1970's, U.S. vulnerability to interruptions in foreign oil supplies, increasing world energy demand, and dwindling conventional energy resources prompted Congress to look toward renewable energy technologies. While while we are now experiencing low crude oil prices, this sudden drop illustrates the volatility of a market which could very quickly turn the other way. Many energy experts predict $50 per barrel for crude oil by the end of the century. A recent study projected that the U.S. will have virtually exhausted its oil supplies by 2020. Without question, the need to develop renewable fuels remains crucial to our strategic security.

Fuel ethanol can play a central role in developing our energy security. Ten percent ethanol blended with 90 percent gasoline can displace 2 barrels of imported oil for each barrel of alcohol. In 1985, 620 million gallons of ethanol was blended with gasoline, displacing approximately one billion gallons (30 million barrels) of imported crude oil. In terms of our trade deficit, the U.S. saved $600 million on crude oil imports.

These enormous benefits generated by our growing domestic ethanol industry are threatened by three specific loopholes in U.S. trade law. The first allows fuel grade ethanol to enter the country under a lower duty for industrial grade ethanol. At present, an importer can bring in fuel grade ethanol, declare it for industrial use, and pay only a 3 percent ad valorem tax. He then has up to three years to reclassify the item as fuel ethanol, in effect securing a three year interest-free loan from the government. Further, some companies have established "dummy corporations" that dissolve just prior to the three year deadline, thereby completely evading the 60 cent duty. My bill would require importers to pay the higher duty for ethanol imports at point of entry. The 60 cent tax would be refunded upon proof that the shipment is intended for industrial use.

The U.S. Customs Service acknowledged the abuse of this loophole, and closed it administratively on September 25, 1985. They noted that imports of ethyl alcohol under the industrial classification had increased over 600 percent in the past several years, while there was no corresponding rise in the demand for industrial ethanol. Customs should be credited for its decision to address this problem, and while I will press for codification of this provision, I look forward to working with Customs to implement the most effective language to enforce this action.

The second loophole permits imports of up to 93% ethanol mixed with gasoline and hydrocarbons, such as toluene, xylene, and ethlybenzene, to receive a lower duty or no duty at all. There is no question that when such mixtures are imported for use as fuel, the only motive for blending ethanol with other compounds is to evade the 60 cent duty. H.R. 1720 would amend the Tariff Schedule of the United States as to apply the same duty to imported ethanol blends as it does to pure ethanol imports.

From personal experience, I can assure you that the mixtures loophole is being repeatedly exploited by very clever entrepreneurs. I have been involved in working to avert two crises precipitated by the exploitation of the "mixtures" loophole, one that occurred last summer and one that is taking place as we speak.

With some encouragement from the American Ambassador to Brazil, the Customs Service in September of 1984 issued the first in a series of private letter rulings allowing 80-90 percent ethanol blended with toluene, benzene and xylene to qualify for a duty of 5 percent ad valorem, rather than the fuel ethanol duty of 3 percent ad valorem plus 60 cents per gallon. It soon became evident that certain importers and marketers were interested in importing Brazilian ethanol-toluene (E-T) blend, at enormous profit. Last year, Brazil, the largest producer of ethanol currently has a one billion gallon surplus which its government committed to exporting.

It was not until receiving repeated urgings from Congress and other interested parties that the Customs Service finally revoked the letter rulings last August, but not without leaving open a temporary window through which potentially millions of gallons of E-T blend could flood U.S. markets. Aware of the long-term trade repercussions that would result from glutting the U.S. market, the Brazilian government took it upon itself to restrict total exports of E-T mixtures. I laud the Brazilian government for responding favorably to the problem. However, I find it incredible that we got results from the Brazilians before our own Administration in Washington saw fit to address the crisis.

The second crisis now emerging involves imported mixtures of Brazilian ethanol and ethylbenzene, which receive duty-free treatment under the terms of the Generalized System of Preferences. Once again, it is evident that certain parties are exploiting this important trade law for purposes of evading the ethanol duty. I have contacted the U.S. Special Trade Representative Clayton Yeutter urging him to take immediate action to remove ethyl benzene from duty-free status, to avoid another wave of cheap imported ethanol. I am pleased to report that Wednesday, February 5, Ambassador Yeutter initiated an emergency product review, which will hopefully result in closing this portion of the mixtures loophole.

We are winning the battle against mixtures, but the process needlessly injures the American industry, and makes a mockery of our trade laws. Parties on all sides of the ethanol issue would almost unanimously concur that this loophole should be closed. I urge the Committee to move expiditiously to do so.

The third, "CBI," loophole in the Caribbean Basin Economic Recovery Act (CBERA) poses perhaps the greatest threat to the domestic ethanol industry, and is the most misunderstood issue in this debate. Detractors of my legislation argue that H.R. 1720 would compromise CBI and remove incentives for American business investments. In fact, my bill seeks to restore the integrity of CBI and promote indigenous ethanol facilities in Caribbean nations.

The loophole was created in 1984, when the Customs Service issued a private letter ruling claiming that the ethanol distillation process constitutes substantial transformation under the terms of the CBERA. This ruling permits non-CBI hydrous, or "wet" ethanol that is simply distilled in CBI beneficiary countries to receive duty-free treatment. My bill would amend CBERA to provide that ethanol produced in a non-CBI country, and then merely subjected to further distillation or denaturing within a CBI country, is not eligible for duty-free treatment. However, it is important to note that ethanol produced from "unified" or grass roots Caribbean plants, would continue to be eligible for duty-free shipment to the U.S.

The intent of CBI has always been to strengthen the small, developing countries in the Caribbean and Central America, thereby protecting them from outside political subversion. An effective route to this end is the promotion of indigenous "grass roots" ethanol plants in the region. These plants would call for substantial capital investment, offer desperately needed markets for CBI agricultural products -- namely sugar cane and molasses -- and generate thousands of jobs.

The domestic industry, which supports development of full scale CBI plants, estimates that the region could reasonably produce 150 million gallons of ethanol per year, within several years. The use of sugar cane as feedstock would greatly improve the depressed world sugar market. An estimated 2,500 construction jobs would be created, and over 1,000 permanent jobs would be generated. The multiplier effect of this type of investment would generate economic benefits for roughly 6 million people.

The construction of simple distillation towers with the same capacity would, in contrast, generate less than 400 construction jobs, 200 permanent jobs and no no new markets for CBI feedstock.

Yet because of the enormous profits distillation towers yield for the investor, the "CBI" loophole removes incentives for investment of full scale plants. This is the last and most simple stage in the production process, and can be carried out by a minimum of twelve employees per facility. The economic benefits to the beneficiary country generated by these pass-through facilities pale in comparison to those yielded by full scale plants. It is estimated that a 20 million gallon per year pass-through facility can yield an annual profit of $8.6 million, allowing the investor to recoup his initial capital investment within a matter of months. As a result, however, the CBI "beneficiary" country and the U.S. are loosers, the latter forfeiting duties totalling $12 million per year.

The inevitable mushrooming of distillation towers in the region will jeopardize existing full scale plants in El Salvador, Costa Rica, Panama, and Puerto Rico, and freeze construction on plants in Honduras and Guatemala. It would be a tragic irony if the CBI policy this administration promoted precipitates the demise of facilities in countries so crucial to our national security. Caribbean nations are looking to Congress now for the support they need to proceed with the construction of full scale ethanol plants. We have an opportunity to restore the integrity of CBI so that the beneficiary countries can profit and grow.

In conclusion, I urge the Subcommittee to carefully weigh the merits of the arguments that will be put before you today. The issues here include strengthening U.S. trade law, preserving American jobs and agricultural markets, reducing the budget deficit, and improving long-term relations with our trading partners and allies in the Caribbean Basin and South America. I believe my legislation provides a solid beginning toward achieving these goals.

Chairman Gibbons. I apologize to you and the others at the table for not giving you a hearing sooner. Our schedule just got preempted by taxes, and we want to move on this very rapidly. I am not a chemist, nor did I ever study chemistry in school, so I only have a vague idea as to how ethanol is created and how this process is carried on.

But one of the things that has haunted us for many years is a subversion of our tariff laws just by simple passthrough operations. It is nothing new. It tends to get a little more complicated all the time.

Are any of you familiar enough with what really takes place with this plant operating in Jamaica and threatening to operate in other places? What kind of chemical process is it?

Mr. Durbin. Mr. Chairman, if I can address that, and I will open my answer to other members of the panel who may have more information. But what this plant is basically doing is receiving feedstock from other countries. We are told that they are receiving hydrous ethanol from Spain or Brazil. It is brought into Jamaica with more water in it than would quality it to be used as fuel-grade ethanol in the United States. It is then put through a distillation or heating process to remove that water and to make it a higher proof ethyl alcohol.

This last stage, which is known as distillation, is a very minor part of the procedure and employs very few people. But because our Customs Service has ruled that a substantial transformation is taking place, this distillation process has qualified this company to reap the entire benefits of the CBI.

Mr. Daschle. The process is 95 percent complete by the time it reaches the stage Mr. Durbin has just addressed. In other words, it is just the final 5 percent of water being removed during the dehydration process. The Customs Service ruling allows marketers to utilize this product for import into the United States duty free even though it has not been substantially transferred according to CBERA criteria. This is a loophole which should be closed. The distillation process constitutes only a very minor part of the commitment that must be made under the CBERA to make this ethanol eligible for duty-free CBI Status.

Chairman Gibbons. When you say loophole, we specifically put in a provision in the Caribbean Basin Initiative, and it is in other free trade zone arrangements, that we have to prohibit the passthrough—I want to make sure we are talking about the same operation. You are talking about it as if it were a loophole, we thought we were closing a type of function, a simple passthrough. Are we talking about the same thing?

Mr. Daschle. I think we are talking about the same thing. In the CBERA, there is a stipulation that says if the product is substantially improved upon and the Caribbean country is the base country in which that improvement is made, then there is no problem.

The real question is the definition of improvement. Are we actually transforming the product and is that really the intent of what is being done in the CBI country? Obviously if a raw material comes to a Caribbean Basin country and the product is then refined and improved to the extent it becomes a viable ethanol product for export to the United States, that is one thing. But, if the product has been completely produced in another nation and then is slightly upgraded in a CBI country—in other words, the icing is just added to the cake within the Caribbean nation—is that an improvement to fit the definition of the law as written? We argue that it is not.

Chairman GIBBONS. Let me confess for parochial reasons, I was concerned about this. I have many constituents, not in the ethanol area, but in the orange juice area, and one of the reasons that we particularly tried to tighten down on the Caribbean Basin Initiative is that we looked at the tremendous production of orange concentrate in Brazil. When you concentrate orange juice, essentially all you do is squeeze the orange, evaporate the water out of it and freeze it. In order to turn it back into orange juice from this solid mass, you just got to warm it up a little, squirt a little water in it, and you are back to orange juice.

And we wanted to prevent that type of operation from taking place in the Caribbean or taking something out of big jars and putting it into smaller jars, that is a simple pass-through, or just adding water.

It seems to me, as a practical matter, what we have here is just the reverse of that. They are just taking the water out of a product in the Caribbean and calling it something else. Maybe chemically it is something else. I guess orange juice, when you squirt a little water in it, is different than before you squirt a little water in it. Am I oversimplifying it as far as you are concerned? Do I understand the process correctly? Is there anything added other than the heat to drive off the water?

Mr. DASCHLE. I don't think you are oversimplifying it. I think your concern about putting the squeeze on citrus is the same. Whether you are taking water out or putting it in, if it is a small part of the process and doesn't create jobs, we are offering windfall profits to countries because of our duty structure which was designed to help create jobs that just aren't there.

Chairman GIBBONS. I think our views are the same. We didn't care if they grew oranges in the Caribbean and took the water out of them and sent them up here and shot a little water back into them. That is different.

Mr. DASCHLE. Not only are they taking water out, but it is the degree of water. It is only 10 percent more than all the water they have already taken out. They are already up to about 90 percent of the water removed. It is just that last amount they are taking out.

Chairman GIBBONS. What worries me is how in the world did they ever get a ruling that allowed them to do that in the face of the legislative history, the clear cut, uncontroverted legislative history? I can show you reams of testimony that we took in this matter.

Mr. MICHEL. Mr. Chairman, I might volunteer. I think under current law a product from the Caribbean nation is allowed into this country duty free if at least 35 percent is added to the value of the product, and while we can talk in terms of just that last fraction, it is that last fraction that makes a difference here, and a considerable one.

Chairman GIBBONS. We tried to modify even that 35 percent by simple passthrough things. You know, those classifications—that orange solution isn't worth much, but when you shoot water into it and shake it up and call it orange juice, it becomes of some value. That is the simple passthrough type of thing that we tried to eliminate not just for orange juice but for all kinds of manufactured products.

As I said, this passthrough problem is not something that is new. It has been going on as long as we have had differential tariff rates for different parts of the world for different products. And it is not something we just recently discovered.

What I am worried about is administratively, and I understand there are some people here from Customs who can perhaps explain to me why they ever allowed it to come in at that rate anyway if it is as you have described, just a simple dewatering process that really doesn't change the nature of the beast. That is what worries me.

Mr. MICHEL. If I might make one other observation. When we enacted CBI, it was my feeling that what we were trying to do was help those countries in the CBI area improve their economic well-being themselves by bringing themselves up by their bootstraps. What our bill would provide here is that any of the ethanol produced 100 percent within the CBI is acceptable, but what we see here is the real intent and purpose of CBI being subverted by the Caribbean nations being used as a conduit for the shipment of ethanol rather than actually producing it themselves.

Chairman GIBBONS. We are going to have to examine this issue and I just want to put the Customs people on notice, we are going to call you sometime this morning to let you all explain to us just where our—I thought we had closed this door already. I was shocked to find that we hadn't closed it.

If the door is, as I understand it, as you describe it, I can't see any reasons for the controversy because I thought the original CBI legislation had taken care of that. I would be interested in the reasoning by which the intent of Congress discussed many times in the hearings, discussed many times in the markup and in the committee report, in the lack of the bill, why it got changed. It concerns me.

Mr. Schulze, would you like to inquire?

Mr. SCHULZE. Thank you, Mr. Chairman.

I, as well as you, am not an expert in this but my understanding is that about $20 million was spent building a plant. If you were going to spend $20 million to build a plant that is not going to do anything, that is an awful waste of money.

Are you telling me that is what happened: somebody went down there to build a plant that actually does nothing?

Mr. LEACH. If I can respond, that figure is in some question.

Mr. SCHULZE. What do you say was spent on building the plant?

Mr. LEACH. I have been told along with Mr. Durbin this morning by experts of the American ethanol industries the facility that is described would have cost to be built in the United States in the neighborhood of $3 to $4 million.

Mr. SCHULZE. Who says this?

Mr. LEACH. These are experts in the United States——

Mr. SCHULZE. Do we have that in some kind of written form?

Mr. LEACH. I referenced it earlier in my testimony.

Mr. SCHULZE. This is an unknown expert.

Mr. LEACH. Well, it is an expert who I will be very happy to submit the name and if you want a letter——

Mr. SCHULZE. That is a pretty big difference. Someone says $20 million——

Mr. LEACH. There is a lot of difference because I also reference in my testimony, it is the estimate of experts in the U.S. ethanol industry, the investment has been recovered and profit based upon what is believed to be production levels.

Mr. SCHULZE. Hasn't production in the United States increased from about $20 million 6 years ago or so to something like $430 million—gallons—not dollars, not dollars, gallons?

Mr. LEACH. Actually higher than that.

Mr. SCHULZE. Isn't 60 percent of it done by one company?

Mr. LEACH. That I cannot reference. But I would stress that——

Mr. SCHULZE. Midland goals, about 60 percent.

Mr. LEACH. That is quite possible but I would like to stress——

Mr. SCHULZE. Isn't that a virtual monopoly?

Mr. LEACH. Well, if I could respond.

Mr. SCHULZE. Sure.

Mr. LEACH. Ethanol has some decentralization aspects. It is the type of industry that smaller plants closer to area of production, if there is a strong green light given that there is a market here, will come on stream. There is an enormous interest in rural American for——

Mr. SCHULZE. Jim, I appreciate that. If you are telling me the growth in this industry is not a green light, I don't know what is. When you go from 20 million gallons to 430 million gallons of production in 6 years, if that is not a green light I don't know how you could get it any greener.

Mr. LEACH. I can tell you how you can get it greener if I could.

Mr. SCHULZE. We could cut out everything.

Mr. LEACH. The Corn Growers Association of the United States is currently setting as a national goal something that many agricultural experts believe is attainable. By the year 1990, that is close to now, of tenfold growth in this industry from where it is today. And the reason I stress this is that you look at that kind of growth, it is very, very significant.

We are at the fledgling stages even though percentage growth over the last 7 or 8 years appears to be quite high.

Mr. DASCHLE. I think that growth presents an incredible amount of potential across the country. In the upper Midwest, even from international exporters, we are going to see that in the Caribbean Basin, we will see it from Brazil and around the world. All we are asking is that in those areas where we have already established a much more level playing field, the loophole in our trade laws that is now being used to subvert the intent of the CBERA be closed.

Mr. SCHULZE. What percentage of imports do you think as a general rule should be equitable? I am talking not necessarily your product, across the board. Steel and everything else. Should we allow foreign producers to penetrate our markets 10 percent, 20 percent, 50 percent, 60 percent? Is there a general rule of thumb that will tell us when to send a little red flag up?

Mr. **Daschle**. I don't think the percentage ought to be the rule of thumb. It seems to me it ought to be considered on the basis of fairness.

Mr. **Schulze**. How do you define fairness? Honest competitive dealing?

Mr. **Daschle**. I think there has to be equal access to their markets as well as to ours.

Mr. **Schulze**. On similar products?

Mr. **Daschle**. On similar products. I think there has to be some kind of similar relationship with regard to subsidization. I don't think unfair subsidization is anything more than——

Mr. **Schulze**. Of course we have rules against that. If there is subsidy going on here and I understand the largest producer in the country is in trouble in the courts. Is that true? Hasn't Midland had a problem——

Mr. **Durbin**. Since their national headquarters is located in my district, I will be glad to tell you what I know. I know of no outstanding lawsuits threatening this company.

Mr. **Schulze**. My understanding is the FTC is investigating unfair trade practices against Archer-Daniels Midland. Are you telling me that is not true?

Mr. **Durbin**. I can't speak to that. If the gentleman is suggesting because there is an investigation going on we should turn our back and ignore this obvious loophole in CBI, I don't follow his logic.

Mr. **Schulze**. Did I suggest that?

Mr. **Durbin**. I am not sure what the gentleman suggested.

Mr. **Schulze**. I am asking questions. If you don't want to answer that, fine.

Mr. **Durbin**. I have answered as far as I can.

Mr. **Schulze**. Let's start over.

Suppose the product was grown, developed and produced in Jamaica, would your qualms—in other words—and I really haven't looked into this.

Mr. **Durbin**. The answer is yes.

Mr. **Daschle**. The answer is yes.

Mr. **Schulze**. My understanding is that there are two phases. They put this plant in and it will take an additional investment in order to have production from sugarcane or whatever it is to bring the plant fully on stream with their own local production. Are you saying that as that two-phase process begins your concerns will be gone?

Mr. **Leach**. Would the gentleman yield because I am not sure you understand entirely the intent of our legislation. We are very supportive of every Caribbean Basin Initiative country being able to produce and market duty-free products grown within the country in the United States.

Two governments within the Caribbean Basin Initiative have argued vehemently this loophole that exists subverts the CBI because it subverts the labor-intensive part of the industry they are trying to develop.

And again, let me stress what the representative of the government of El Salvadore told Congressman Durbin and myself at breakfast this morning, not only will it subvert the prospect of them making greater investments in ethanol, but it destroys their largest existing single industry which is the sugar industry they are trying to seek new markets for.

And what this particular loophole does is allow non-CBI countries to take advantage of legislation specifically designed to help CBI areas out.

Mr. **Schulze**. Let me tell the gentleman I had a great deal of concern over that as the legislation was developed and we certainly didn't address all of my concerns. But we addressed the concerns of many of the members of the committee. I agree that we should have done it at that point. We went into quite some detail on substantial transformation. Perhaps you can tell me a little bit more about distilling, denaturing and upgrading of ethanol. Customs has ruled it is substantial transformation. As the chairman said, I am not a chemist, but apparently this is an extensive process.

Mr. **Leach**. If you would yield you are talking to three nonexperts, but what we have been able to glean from representatives of this industry, and I would like to stress I do not represent Archer-Daniel Midland's, there is no plant of that company in my congressional district, but from representatives of the National Corn Growers Association and the Renewable Fuels Association, it is my understanding that what this facility simply does is dehydrate, it takes water out of the product as it arrives on the shores, that this dehydration process is a very simple process.

Mr. **Schulze**. And where does it come from?

Mr. **Leach**. Largely it comes today from Brazil, although there is some existing material that apparently also was derived from Spain.

Mr. **Schulze**. Are you saying largely——

Mr. **Leach**. This is one belief, but I cannot tell you from independent verification that that is the case.

Mr. **Schulze**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Bill.

Mr. **Frenzel**. Thank you, Mr. Chairman.

I want to thank our three distinguished colleagues for making their presentation. They represent important producing areas in the United States, and for each of them I think their constituents would be pleased to know they delayed their trips to their district to present their testimony. We very much appreciate that.

Jim, with respect to your last remark on what you do, it is quite a bit different than simply reducing water out of a product. I am not a chemist. But what do we call the isotropic distillation? As I understand it you have to break a chemical bond between water and ethanol that requires some engineering and a whole heck of a lot of capital, and a fair amount of equipment.

Mr. **Leach**. If the gentleman will yield.

Mr. **Frenzel**. I am asking you.

Mr. **Leach**. There are a number of types of ethanol facilities, some of which are very sophisticated, involving the fermentation process and involve substantial capital investment. The particular kind of facility we are referring to in Jamaica is of the simplest variety, one that involves the least capital investment and as I indicated earlier and I am basing my statements on statements given to me by experts in the industry in this country that that particular facility involves a substantially lower capital investment than has been indicated to the committee prior to this time.

A capital investment in the $3 to $4 million range if the facility were built in the United States, and it is——

Mr. **Frenzel**. In what range?

Mr. **Leach**. The $3 to $4 million range rather than the $20 million range that has been indicated earlier, and that there is some thought that perhaps given the low labor cost in the country in which it was built it might have been built for less than that.

Mr **Frenzel**. I thank you. I have a company in my area which has expended or committed $13 million to the construction of such a facility in one of the Caribbean Basin countries and that company is exceedingly nervous about seeing its investment ruined, which it undertook literally at the request of the State Department when the Caribbean Basin Initiative was forming.

Mr. **Leach**. I understand that. I would only respond and I do this very carefully, that the labor intensivity of dehydrating facilities is minimal, and that what you are really dealing with is an integrated industry approach and that if countries in the region cannot develop ethanol facilities of a sophisticated nature which involve substantially more capital investment than the particular facility that exists because they cannot compete with outside country involvement, not only will that investment not take place, but the labor-intensive aspect of all this which is related to agricultural production will be jeopardized significantly.

Again I would only stress the Governments of Panama and El Salvadore sent up representatives this morning at government expense to present official positions, which indicates that in their judgment no single issue more jeopardizes the CBI than this particular loophole. Even though it certainly would have to be acknowledged that in a particular instant some new employment would be gathered in other countries, but it would be jeopardizing far more employment in other countries.

Mr. **Frenzel**. I think if you talk to the Government of Jamaica, however, they would tell you that they have invited this investment, that they like the investment and however few jobs there are resulting from it, they cherish those jobs, they cherish the taxation of the operation and they are trying to expand their canefields or whatever is servicing it so they will not have to take the conversion.

Mr. **Leach**. If you will yield on that point, I have been informed and again I am not speaking as an expert, but I have been informed that Jamaica is in a somewhat unique position, because their sugar production entirely come under both common market and U.S. quotas and that they are actually importers of sugar. This puts them in a different position than all other countries in the region in that regard. Other counties in the region are very concerned about the existence of their current sugar industries, which because of quoting as well as because of the falling prices means that their labor is in significant jeopardy today and that this particular process will allow excess from outside the CBI to ruinously affect their own existent industries as well as jeopardize future investment that they want to make in far more expensive and complicated and sophisticated ethanol facilities, and as a hallmark of that the Government of El Salvadore has already invested $20 million of its own money in such facilities and is prepared to invest another $20 million on a private line of credit to private companies in this area.

Given the difficulties in that country, it is impressive just how large those sums of money are.

Mr. Frenzel. You are correct. I know the gentleman from Illinois would like to comment.

Mr. Durbin. Late last year representatives of the Government of Jamaica visited my office and I believe the gentleman from Minnesota correctly characterized that attitude toward some of the potential ethanol facilities being considered but I might add, they were also very critical of other companies that were trying to locate on their island and for the very reason of creating this passthrough with little or no interest in the indigenous economy of Jamaica.

Mr. Frenzel. The gentleman's point is well taken.

Mr. Durbin. If I can say one other point in closing because mention has been made of the Midland Co. This legislation which we are offering to the subcommittee and asking them to consider today leaves open the very real possibility that a flourishing industry emerge in the Caribbean Basin. In fact, we support it. But it has to be an indigenous industry which really brings value and economic growth to those countries. If CBI is only going to be used as a passthrough the losers will be the domestic ethanol industry as well as the Caribbean Basin nations.

Mr. Frenzel. I think it is a good statement. I would also tell the gentleman that his constituent was formerly located in our city and there is lots of good will.

Mr. Durbin. Moving from Minnesota may have been their only bad decision.

Mr. Schulze. My question, gentleman, is, I understand that the Federal Government has some involvement with subsidization of this industry. Can you tell me how much that is and to what degree we subsidize?

Mr. Durbin. Is the gentleman referring to the domestic industry?

Mr. Schulze. Yes.

Mr. Durbin. At the present time there are several tax exemptions made available to that industry. During the tax reform debate the excise tax exemption of 6 cents was maintained through 1991.

Mr. Schulze. Let us just say today, because that bill hasn't passed.

Mr. Durbin. Today the excise tax exemption is in place——

Mr. Schulze. Excise tax exemption?

Mr. Durbin. Yes.

Mr. Schulze. That is another 6 cents——

Mr. Schulze. Any idea what that amounts to a ye

Mr. Durbin. I don't know the dollar amount.

Mr. Schulze. Go ahead. And that is all.

Mr. Durbin. There is a second tax provision not utilized to a great extent and I can't recall its exact name. I think it is known as a blenders' credit and the tax reform bill eliminates it to keep the excise tax exemption in place.

Mr. **Schulze**. Do you have any idea how much we have subsidized the ethanol industry?

Mr. **Durbin**. I don't have a dollar amount that I can quote.

Mr. **Schulze**. Any idea?

Mr. **Daschle**. We can supply it, certainly, for the record very definitively but I think it is somewhere around $200 million in 1985.

Mr. **Schulze**. $6 million?

Mr. **Daschle**. In fact, I had better withdraw that figure until I know for sure. We can supply it to the committee for the record.

[The following was subsequently received:]

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February 21, 1986

FEB 24 1986

The Honorable Sam Gibbons
Chairman
Subcommittee on Trade
1136 Longworth HOB
Washington, D.C. 20515

Dear Sam:

During my testimony before the Subcommittee on Trade on February 7, I indicated that I would provide additional information on two specific points.

I was asked how much the federal government subsidizes the domestic ethanol industry. The cost to the Treasury of the federal excise tax exemption for alcohol fuels in 1985 was $240 million. At the same time, the expanding ethanol industry added more than $800 million to farm income, reduced federal outlays for farm price support programs by $150 million and displaced over $600 million worth of imported oil.

It is significant that the Ways and Means Committee reviewed this particular excise tax exemption during its comprehensive tax reform hearings last year. H.R. 3838 leaves the exemption intact until its current law expiration date of December 31, 1991.

Also, during a discussion of the federal role in promoting ethanol production, I cited a figure for the cost of federal subsidies for other energy sources. This reference requires clarification.

A 1978 study by the Batelle Memorial Institute for the Department of Energy found that more than $252 billion was allocated to energy producers between 1921 and 1978. More than $138 billion went to oil and gas, $64 billion to electricity, $21 billion to nuclear, $17 billion to hydro, and nearly $12 billion to coal.

According to the Center for Renewable Resources, the federal government spent $44 billion to subsidize the energy industry in 1984. More than $41 billion of that total was provided to mature energy technologies which long ago reached commercialization. All of the emerging renewable energy sources -- solar, wind, waste-to-energy, ethanol and geothermal -- received $1.7 billion.

The Honorable Sam Gibbons
PAGE 2
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I hope that this information will be helpful to the Subcommittee and that it will be added to the hearing record.

With best regards, I am

Sincerely,

Tom Daschle
Member of Congress

TAD/pmr

Mr. **Schulze**. I see a statement by the National Corn Growers Association that by providing a market for estimated 222 million bushels of corn that it has increased the price of corn by 10 cents a bushel.

Mr. **Durbin**. 9.9.

Mr. **Schulze**. It says it cost the consumers $849 million and has put that much into the farm community. Would that be fair?

Mr. **Daschle**. We should add to that also consumers have not had to pay the $150 million in taxes that otherwise would have gone to farmers through farm price support programs on an annual basis. This was $150 million in 1985. So you have got the equivalent of perhaps over the period of time since 1979, more than $1 billion in savings to the farm program itself.

Mr. **Schulze**. In your opinion can the ethanol industry stand on its own feet in a competitive world without any subsidization?

Mr. **Daschle**. Ultimately, absolutely, yes.

Mr. **Schulze**. But not today?

Mr. **Daschle**. I recall seeing a $1 billion figure for ethanol as it was compared to the oil and gas industry subsidy over the last 25 or 30 years of more than $75 billion. That is a figure that I can also verify for the committee record.

But given the comparison, given the obvious need we have to insure adequate energy supply, adequate availability in a diverse sort of way, we have seen fit as a nation through policy to commit more than $75 billion in industry subsidies to the oil and gas industry alone over the past several decades.

So obviously when one looks at the viability of ethanol, the potential for growth, the opportunity to offset the cost in the farm program, the tremendous new opportunity it provides for expanding agricultural markets, there is no way to properly assess the cost/benefit ratio in terms of tax dollars. But, clearly, when you show it in comparison to oil, when you show it as an offset to farm cost, when you show it in terms of economic viability generated to the economy, I think we are getting a real bargain with regard to the investment made through the excise tax exemption today.

Mr. **Schulze**. In all this talk in newspaper articles about Archer Daniels Midland pulling the strings and controlling these Members of Congress and influencing this, they can control the market, I mean you think that really——

Mr. **Durbin**. If I could address that.

Mr. **Schulze**. That is a lot of money, isn't it?

Mr. **Durbin**. Let me suggest this. The comments about the FTC investigation, the monopoly, the pulling strings, the legislation before us——

Mr. **Schulze**. These are newspapers articles.

Mr. **Durbin**. If we are going to believe everything we read in the papers——

Mr. **Schulze**. That is why I am asking.

Mr. **Leach**. Mr. Chairman, the gentleman from Pennsylvania is impugning the motive of witnesses before this committee.

Mr. **Schulze**. No, I am not. Wait a minute, Jim. I asked a question whether these articles which seem to condemn this company and say that they are trying to control this market, whether, in your opinion, there is any truth to this or whether this company is really willing to compete on an open basis and is just fortunate to be in the forefront.

It is a very simple question.

Mr. DASCHLE. I wish the gentleman had phrased the question that way in the first place. That isn't the way it was phrased. I am like Mr. Leach.

Mr. SCHULZE. I haven't read anything good about them. They are not in my district. Everything I have read about them is bad.

Mr. LEACH. I would like to respond to the gentleman from Pennsylvania, if I could.

Chairman GIBBONS. Go right ahead.

Mr. LEACH. I would not speak in behalf of the motives of any other Member of Congress, but I would say Archer Daniels Midlands has no interest in my district, no employees in my district. I have never received any campaign contribution from anyone associated with the firm, as I know of. I have a rule against taking PAC money from outside my State.

I do not represent Archer Daniel Midlands. I represent what I think is in the best interest of my constituents and that is why I have introduced this legislation. I think that——

Mr. SCHULZE. Jim, you don't think they are the motivating factor behind this legislation and they didn't talk to you about it?

Mr. LEACH. Mr. Chairman, I would respond to that. I developed this legislation which was the first of its kind introduced in this body. Comparable legislation was introduced by the Senator from Kansas in the other body.

I did not speak to a single soul associated with that company about that legislation until after I had introduced it. When it happened, I was at a dinner party with a representative of that company. No one approached me before this legislation was earlier introduced.

To my knowledge, as far as my involvement is concerned, they are irrelevant. What I am concerned about—the farm producers in the United States of America who has the largest vested interest. All refiners are intermediaries of a small percentage nature in terms of the final product cost.

What I am concerned with and what I am confident my two colleagues that are with me at this table are concerned with is markets for production in this country and whether the United States is going to play patsy to foreign subsidized products and companies that use loopholes in the tax laws of the United States. That is why I think this loophole——

Mr. SCHULZE. I agree with you but when you have got the charge on the other side that you have got a company that is using loopholes and political pressure, you have got to say you almost have the same argument on the other side. That is all I am trying to get. We are getting the thing from both sides and we have got to determine where the facts are.

Chairman GIBBONS. I don't want to interrupt this, but we have two more panels of people from out of town and I am going to quit at 2 o'clock. So let's wind it up.

Do you have anything else you want to say?

Mr. DASCHLE. Thank you, Mr. Chairman.

BEST COPY AVAILABLE

Chairman GIBBONS. Let's have the first panel come forth, Renewable Fuels, Peerless Oil, E.F. Hutton, and the National Corn Growers Association.

STATEMENT OF ERIC VAUGHN, PRESIDENT, RENEWABLE FUELS ASSOCIATION

Mr. VAUGHN. I want to thank you very much for this opportunity. My name is Eric Vaughn. I am president of the Renewable Fuels Association, which is the domestic trade association for the domestic ethanol industry.

In the interest of time, I would like to submit my written comments for the record and keep my oral comments as brief as possible.

Before I start speaking, I would like to thank the four Members of Congress who gave up their time to be with us on such an awful day to come forward and talk about legislation that is very important and vital to this domestic industry and to the farmers and others who are depending so heavily on it.

The national trade association, the Renewable Fuels Association, represents roughly 100 companies who invested nearly $2 billion in facilities, plants, and equipment throughout the United States of America. We are proud of the accomplishments we have achieved since the legislation was first introduced in the late seventies to provide the incentives for this industry and we believe in all sincerity that the same can be accomplished throughout the Caribbean Basin.

We are here today in support of the measures introduced by Congressmen Leach, Durbin, and Michel, principally because we believe, and as these Congressmen have expressed through these legislative initiatives, that loopholes in the ethanol tariff laws have been opened in just the last 18 months.

Ways that ethanol imports have come into the United States and have escaped the tariff laws include blending with toluene and benzene. The primary reason for exploiting the loopholes is to circumvent the 60-cent tariff.

I don't think the ethanol incentives and offsetting tariff are well understood. There is a current exemption from the gasoline tax from ethanol blended in the United States. All ethanol produced in the United States and imported into the United States has full and complete access to that exemption. The tariff was put in place to be equal and offsetting to that exemption.

Essentially, an importer is required to pay the 60 cents tariff when product is coming in to the United States and the importer gains the full exemption benefits in the United States designed principally for the domestic industry.

Chairman GIBBONS. It is a pretty high tariff and I, frankly, don't like it worth a damn, but I can't get rid of it. If I had my way, there wouldn't be that tariff, but I don't have my way. Some day I will. I want to put all the people in the audience on notice.

I don't like that tariff. I think it is too high, and I think it ought to be reduced or eliminated entirely, but I don't have enough votes to do that right now.

Mr. **Vaughn**. We believe when the Congress established the incentive, it was an incentive to induce the domestic industry to——

Chairman **Gibbons**. It was done about 4 o'clock in the morning in this room. I happened to have been present. There was not a lot of consideration of it, so you can cover it up any way you want to, but I was here when it happened.

Mr. **Vaughn**. Yes, sir. Our reasons for supporting the legislation, under consideration today in specific deals with one measure in the legislation. We discussed it quite a bit this morning. With regard to the development of the CBI and the ethanol industry in CBI countries, you have talked about or mentioned representatives of countries—Panama and El Salvador—coming here at the request of their Presidents to point out that they have invested as a direct result of the CBI legislation that you all produced in the CBI to develop an ethanol industry throughout the CBI.

They feel, as we feel, a tremendous threat as a result of what is developing as simply a passthrough, nothing more than a passthrough in the Caribbean for wet alcohol.

I would like to correct one statement. One of the members just prior to this panel mentioned that ethanol is coming into the United States with 10 percent water in it. It is not quite that wet. It is 5 percent water. This is 95 percent finished product coming in from Brazil and Spain, stopping off in Jamaica and if they have their way, other Caribbean nations for the sole purpose of dropping off 5 percent water and picking up a tariff-free duty status to come into the United States.

Mr. Chairman, we were discussing the differences between full fermentation facilities and simple drying facilities earlier with the Members of Congress. I would like to submit for the record, if I might, a picture. While we don't have pictures of ethanol facilities in the Caribbean, we have something very close to it. I am not sure if you were given these pictures or not, but what you are looking at—essentially at the fold is a facility, an azeotropic distillation tower, that is 2½ times as large as the Tropicana one in Jamaica.

Now, if you open the picture, obviously done for dramatic effective, you will see a full fermentation facility. This is the New Energy Co. of Indiana, a 50-million gallon facility, again, 2½ times what is in the Caribbean, but you will see the full fermentation activity. This is what we would like to see developed in the Caribbean, and what we currently have in three CBI nations, El Salvador, Guatemala, and Costa Rica.

The development of the CBI ethanol industry, a full fermentation industry in the CBI was progressing at a rapid rate for CBI countries until September 1984 when the Customs Service provided a private, special letter ruling to one company to go down to the Caribbean and make not a $20 million investment, but by their own testimony, a $5 million investment in a simple 20-million gallon dry facility.

We have an expert with us here today, the president of the Pekin Energy Co., Art Stunkel, who can answer any technical questions regarding ethanol production, but a comparable drying facility in the United States would cost somewhere in the area of $1 million, and require five to six people to operate.

There is one other statement I would like to make. I know time is short. I received a letter just before I came over here this morning from Ricardo Kriete, who is the president of El Salvador's privately held ethanol company. In the letter he states that it has taken both "economic and human sacrifice to make our exports of ethanol possible."

"It provides many jobs to El Salvador, the worker in the sugarcane fields, port personnel, and 1,000 in between. We must resist short term opportunities that circumvent domestic opportunities that can and will provide economic independence in the free market."

Mr. Chairman, I submit to you your legislation, the CBI bill is working in the Caribbean Basin. Companies are looking to invest to create economic growth and the ethanol fuel industry supports that growth.

We believe the CBI can mirror what the U.S. ethanol industry has achieved in ethanol production. I thank you very much and would be happy to take any questions.

[The prepared statement follows:]

STATEMENT OF ERIC VAUGHN, PRESIDENT, RENEWABLE FUELS ASSOCIATION

INTRODUCTION

The Renewable Fuels Association, the only Washington, D.C.-based organization for the purpose of supporting the interests of the domestic alcohol fuels industry and other renewable fuels technologies before the Congress and various federal agencies, strongly endorses H.R. 1720, H.R. 1566 and 1567 legislative proposals designed to ensure regular payment of duties imposed on imported ethyl alcohol used in producing a mixture of gasoline and alcohol as a transportation fuel.

The RFA believes that unless these bills, or similar legislation, are passed by the Congress in the very near future, actions taken by the U.S. Customs Service will allow millions of gallons of fuel grade ethanol, which normally would be subject to a 60 cent per gallon duty, to enter the United States duty-free merely because its water content was reduced by processing in a nation which qualifies under the Caribbean Basin Initiative Economic Recovery Act, a chemical was added to ethanol creating a "new" article of Commerce, or misclassified ethanol shipments were allowed to enter the U.S.

THE FEDERAL GOVERNMENT'S COMMITMENT TO DEVELOPMENT OF THE DOMESTIC ETHANOL INDUSTRY.

In the last several years the federal government has demonstrated on many occasions its commitment to the development of a domestic fuel ethanol industry. This effort began in 1978 following two serious disruptions of international petroleum supplies for the U.S. market. Briefly stated, the thrust of the program was to reduce our dependence on imports of foreign oil through the creation of a domestic industry which would convert this nation's vast surplus of grain to transportation fuels.

This is being accomplished through a number of federal and state incentives, including loans, loan guarantees, and energy investment tax credits for the construction of ethanol production facilities and a program of reduced gasoline taxes for refiners, blenders, and retailers who would blend fuel grade ethanol with gasoline for sale to the public. Since it was the government's intention to promote the production of fuel grade ethanol within the United States, a tariff was imposed on imported ethanol destined for the fuel market which has the effect of offsetting the tax incentive for ethanol's use in gasoline blending. This mechanism was chosen because it reduced the administrative burden required to trace imported ethanol to the final customer. All agriculturally-derived ethanol, once imported, qualifies for the tax incentive for blending with

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gasoline subject to the offsetting duty imposed before it enters into commerce. In this manner, the benefits of the excise tax incentive on blended gasohol remain within the United States.

The devastating economic and social effects of disruptions in the supply of oil imports from the Middle East during the 1970's forced this country to recognize the need for substantial and creative efforts to reduce the nation's dependence on foreign oil supplies. In 1978, as part of its effort to develop greater energy independence, the United States government adopted a multi-faceted national policy to support and nurture the development of a domestic fuel ethanol industry.

Federal initiatives implementing this policy include an excise tax exemption and other tax incentives, cooperative agreements, research and development grants, and the federal tariff. The government has also invested, in the form of guaranteed loans, millions of dollars in the construction and development of ethanol production facilities at various locations throughout the country.

The success of this policy has been dramatic. Over 135 domestic production facilities have been constructed representing an investment of more than one in a half billion dollars. U.S. production of fuel ethanol has increased over forty-fold since 1978, climbing from 10 million gallons in 1978 to 625 million gallons in 1985.

The impact of this growth both on the nation's dependence on foreign oil supplies and on the trade deficit has also been substantial. Each gallon of domestically produced ethanol displaces as much as 2 gallons of imported oil, which saved the country $450 million in 1984 and $550 million in 1985 on it's oil import bill. The food by-products from ethanol production provide an important source of exports which, when combined with the savings on imported oil, reduced the nation's trade deficit by over $700 million in 1985.

Indirect economic benefits have been equally significant. The 1985 domestic production alone generated over $1.9 billion in economic activity, creating thousands of jobs in heavily depressed sectors of the labor force: agriculture, construction, trucking, and the railroads. In 1985, ethanol production increased the income of our nation's farmers by roughly $850 million.

Moreover, this growth in the ethanol industry has generated these economic benefits at virtually no cost to the federal treasury. A 1984 GAO report determined that the lost revenues from tax exemptions afforded ethanol are more than offset by an even larger decrease in federal outlays under agricultural price support programs, due to the increased demand for corn in producing ethanol.

Industry analysts project that technological advancement and the increased value of ethanol as an octane enhancer will, over the next 5-10 years, make ethanol blend gasoline more cost-competitive than ordinary gasoline, possibly reducing the need for federal and state excise tax exemptions. Industry analysts also project that, given the proper economic support by Congress, the domestic ethanol industry's annual production could increase four-fold, producing 2.5 billion gallons of fuel ethanol every year. Increasing annual production to only one billion gallons by 1990 would cut oil imports by 22%, increase farm income by $3.59 billion, and generate over $4 billion per year in economic activity.

In reliance on the federal commitment of continued support, both our nation's farmers, through the National Corn Growers Association, and domestic ethanol producers have made substantial contributions to the growth of the industry by investing millions of dollars in market development programs. These programs, which include the formation of an ethanol trade association, numerous symposia and seminars, and an extensive media campaign, are generating substantial market acceptance of ethanol as a clean octane-enhancing gasoline additive.

Circumvention of the Ethanol Tariff

Developments of the past year indicate that the future of the domestic ethanol industry could be undermined by enormous quantities of substantially underpriced ethanol flooding the U.S. market from outside the country. Fuel ethanol imports have increased from less than five million gallons in 1981 to more than 122 million gallons in 1984, representing more than 21% of the domestic market. The vast majority of these imports have been fuel from Brazil which has been able to reduce the price of its ethanol exports because of the scope of its own government subsidy program. Excess stocks of wine in Spain also increase the threat of additional imports of Spanish ethanol in the U.S. market.

The special tariff on imported fuel ethanol (TSUS 901.50) was established by Congress to offset the federal excise tax exemption for gasoline blended with ethanol. This ensured that the exemption promoted development of the domestic ethanol industry, as Congress intended. However, a series of U.S. Customs Service private letter rulings beginning in 1984 have permitted the widespread importation of fuel ethanol free of the $.60 per gallon tariff which was intended to offset the $.60 per gallon blender tax credit to the $.06 per gallon excise tax exemption for 10% ethanol/90% gasoline blends. The means through which this has been accomplished include:

1. Azeotropic distillation of hydrous ethanol imported into CBI nations from Spain and Brazil. 20 million gallons per year (mgy) of this ethanol will have been processed since March, 1985 at the only facility of this kind currently operating in the CBI region at Kingston, Jamaica. Many more facilities are planned.

2. Ethanol-toluene mixtures imported under a series of Customs rulings during June-November, 1985. an estimated 45-55 million gallons were imported duty-free during that period.

3. Ethanol-benzene-xylene mixture Customs rulings which permit duty-free entry imports under the Generalized System of Preferences (GSP) from nations such as Brazil.

4. The real prospect that ethanol mixed with other motor fuel components (e.g. benzenoid compounds) could be imported free of the $.60 tariff under a dozen other TSUS articles and headings.

In addition to these products being free of this tariff (TSUS 427.88 and 901.50), they also qualify for the blender tax credit and the tax exemption. Therefore, the federal government loses $.60 per gallon on every transaction described above, under current Customs rulings.

Since all fuel grade ethanol, once entered into U.S. commerce, qualifies for the federal tax exemption on gasohol blends, foreign ethanol producers and ethanol traders enjoy an overwhelming economic advantage when they avoid the duty which offsets this tax exemption. We believe the recent rulings by the Customs Service stating that foreign ethanol need only be upgraded from one proof level to another in a Caribbean country to qualify for duty-free status can be used to circumvent the tariff and will result in irreparable harm to the domestic ethanol industry. Millions of gallons of wet ethanol bound for the U.S. which otherwise would have entered as dutiable anhydrous products are now being dehydrated in Caribbean facilities. These amounts are certain to escalate in the face of a 60 cent per gallon economic driving force unless immediate corrective action is taken by the federal government.

Fuel Ethanol Production and the CBERA

Under the Caribbean Basin Economic Recovery Act (CBERA) an article of commerce imported into the U.S. from a beneficiary country is eligible for duty-free entry if: (1) the article is a new or different article of commerce which has been produced in a beneficiary country; and (2) 35% of the cost or value of the materials and related processing of the article was accrued in the beneficiary country. Anhydrous ethanol is not a new or different article of commerce vis-a-vis hydrous ethanol (usually 150-190 proof), and does not meet the eligibility criteria set out under the CBERA. Therefore, it should not be allowed to enter the United States duty-free. Also, since neither anhydrous nor hydrous ethanol undergoes substantial transformation in a beneficiary country, neither their cost nor value can be included in the 35% added value-content requirement. Thus, neither of the criteria for duty-free entry is fulfilled.

CBERA, in addition, expressly excludes an article from duty-free treatment by virtue of its merely having undergone "dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article." This exclusionary language was added to ensure that the intent behind duty-free treatment under the CBERA (i.e. encouraging economic development and employment opportunities within the Caribbean) would not be frustrated by simple processing which did not contribute to these goals, In this case, just the opposite of dilution (i.e., dehydration) is occurring , but the result as far as the CBERA's goals are concerned is the same. Since diluting anhydrous ethanol with water in order to produce hydrous ethanol would clearly not result in a "new or different article of commerce" so, too, merely dehydrating hydrous ethanol to produce anhydrous ethanol should not result in a new article of commerce entitled to duty-free treatment under CBERA. Accordingly, we believe the Customs Service's determination is in error.

Importers of foreign ethanol and their supporters have erroneously attempted to characterize H.R. 1720 ad H.R. 1567 as an anti-CBI measure that will undermine economic development of the region. In fact, we believe H.R. 1720 and H.R. 1567 will have a positive impact on CBI and economic growth in the Caribbean Basin Countries.

In the first place, it would be a mistake to believe that ethanol drying facilities such as the Tropicana project represent the only, the first, or even the most significant investment under CBI. Although CBI only went into effect two years ago, it has already had a substantial impact on improving the economies of that region. Manufacturers of a wide variety of products, including electric motors, sporting equipment, pocket books, bedroom slippers, food products, and computers, have set up or expanded production in the area. CBI-eligible imports from designated countries in 1985 increased by about 17% or $555 million, compared to a 26% decline for eligible countries in the region that do not participate in CBI. U. S. exports to CBI countries increased $318 million in 1984, the first increase since 1981.

The Caribbean ethanol industry is currently in the initial stages of development. Full production facilities are currently operating in Costa Rica, El Salvador and Guatemala, producing 20 million gallons of sugar-based ethanol, with another 26 million gallons of planned capacity. In addition, 35 million gallons of fermentation ethanol production capacity are in various stages of development in the Dominican Republic, Panama, and Honduras.

If Brazil, Spain and others are permitted to exploit the recent Customs Service ruling, which grants duty-free status to imported ethanol which is merely "dried" in the Caribbean on its way to the U.S., the development of a CBI ethanol industry will be severely undermined. CBI-produced ethanol will not be able to compete with the heavily subsidized, underpriced ethanol of these countries, leaving the Caribbean with nothing but simple drying operations that are grossly inefficient and offer relatively little benefit to CBI.

"Azeotropic distillation," the process by which hydrous ethanol (190-proof) is further distilled into anhydrous ethanol (200-proof), involves nothing more than adding some benzene to the hydrous ethanol and heating it, causing the benzene to vaporize and carry away most or all of the remaining water. The whole process is very simple and has been used for decades.

The "dehydration" plants are relatively inexpensive and can be constructed in less than five months. Tropicana has stated that its 20 million gallon per year dehydration plant has generated 40 new jobs. Yet the federal treasury stands to lose $12 million per year in uncollected tariff revenue (60 cent per gallon) from this plant alone, an exorbitant price to pay for only 40 jobs.

Compared to the overall production of ethanol from raw agricultural products, this final "drying" step is very minor, and it is extremely inefficient to construct a separate facility for this final task. This process amounts to nothing more than an effort to avoid the payment of the lawful duty, constituting a mere pass-through and a clear abuse of CBI. Congress explicitly drafted CBI "to prevent pass-through operations in which the work performed is of little economic benefit to the Caribbean and constitutes avoidance of U.S. duties."

Brazil and others are certain to exploit such "pass-through operations" in order to avoid the 60 cent per gallon tariff. Under the Customs Service ruling, an importer can simply add water to 200 proof ethanol in Brazil or elsewhere, send it through a Caribbean dehydration plant, and then receive duty-free entry into the U.S. A leading Brazilian ethanol producer recently testified before the International Trade Commission, "I can produce anhydrous or hydrous, the difference is so small. I always produce anhydrous ethanol because the costs are smaller, because storage is smaller and every time somebody wants to buy hydrous ethanol, I just add a little bit of water. It is as simple as that.

H.R. 1720 and H.R. 1567, far from harming CBI, will have the important effect of encouraging investment in and development of grass-roots ethanol facilities in the Caribbean countries that can produce ethanol from sugar cane or other raw materials. Ethanol produced in these plants would remain eligible for duty-free treatment under CBI. Such plants would generate hundreds of jobs, a new and substantial market for CBI agricultural products, and long-term economic development substantially greater than what could be generated by simple and inefficient drying operations.

Although the policy goals of the CBERA are laudable (i.e., to promote economic revitalization and facilitate expansion of economic opportunities in the Caribbean Basin), its reach should be interpreted narrowly when the possible result would be to frustrate such a clear expression of Congressional intent.

ETHANOL OPPORTUNITIES FOR THE CBI REGION

The following is a synopsis of the domestic ethanol industry's position with respect to grass-roots production in the Caribbean Basin region.

1. Sugar Utilization: 950,000 tons of sugar are currently available in the CBI region for ethanol production of 150 mgy which could be easily annexed to existing sugar mills. Removal of sugar surpluses of this magnitude would help support sugar prices in the CBI region and reduce the need for U.S. price supports and quotas. CBI dehydration-only facilities utilize no CBI sugar or other feedstocks.

2. CBI Job Creation: it is estimated that 2,500 construction jobs would be created during the two year period required to build this ethanol production capacity. Over 1,000 permanent jobs (e.g. plant operations, etc.) would also be created. The incomes of nearly 1 million persons in the agricultural sector would be improved, with the "ripple effect" in CBI economies benefitting an additional 6 million people. This is in contrast to 300 or so construction jobs, 200 permanent jobs, and zero agricultural jobs created by drying-only facilities of equal capacity.

3. Positive Impacts on GNP and Balance of Payment Problems Faced by CBI Nations: Grass-roots production of ethanol in CBI nations would greatly improve their gross national products, increase government revenue through an improved income tax base, property taxation, and sales tax revenues. With increased government revenues created by the "ripple effect" of grass-roots fuel ~~ethanol production, CBI nations would be better able to repay~~ outstanding loans.

4. Political Dividends to the U.S.: Domestic agricultural and fuel ethanol industries support grass-roots production of ethanol in the CBI region. 150 million of dried ethanol vs. the same amount of grass-roots ethanol will have the same effect on the U.S. treasury, from the standpoint of the tariff. However, the costs of grass-roots ethanol produced in the CBI region would be more competitive with U.S. produced ethanol, and therefore could more fairly compete with U.S. grain-derived fuel ethanol. Economies strengthened in part by fuel ethanol production would reduce potential illegal immigration to the U.S. by increasing employment opportunities at home. This, ultimately, helps to reduce the influence of potentially destablizing political forces in CBI nations.

Impact of H.R. 1720 and 1566,1567 on CBI Ethanol Production

Pursuant to the CBI distillation private letter rulings, Tropicana built a facility to "dry" 20 mgy of ethanol for a total investment of an estimated $3-5 million. The total cost of drying this product, purchased in "wet" (or around 190 proof) form, including the actual costs of drying, transportation, labor, energy, and debt service is estimated to be $.17 per gallon. offset against the duty which would otherwise be imposed on fuel ethanol, the producer nets a profit of $.43 per gallon. Therefore, this 20 mgy plant can yield an annual profit of $8.6 million and retire the original capital investment in 4 to 5 months, a phenomenal rate of return for any legal enterprises.

In view of this correctly-perceived "windfall" available in the CBI region, a number of similar facilities are being planned by some U.S. company. They will only take months, not years, to become operational. Wet ethanol drying capacity in the CBI region could reach 300 mgy before the end of 1987, representing a loss to the U.S. Treasury of $172 million and windfall profits to producers of $123.3 million per year, with little return to CBI nations, and great harm to U.S. agriculture and ethanol industries, whose products are displaced by such imports.

Needless to say, CBI economic development is not enhanced by this practice. A cornerstone of the CBERA was development of stable economies in the CBI area by stimulating U.S. investment in grass-roots production for the purposes of creating jobs, lowering illegal immigration rates, and lessening the effect of Communist insurgencies in a politically explosive region whose future is one of vital concern to the U.S. Poorly conceived U.S. policy could emasculate CBERA and fail to accomplish its intended purposes.

This legislation would effectively end this unfair "windfall" and encourage grass-roots investment in the Caribbean by eliminating the current uncertainties surrounding U.S. policy on CBI fuel ethanol.

CONCLUSION

Mr. Chairman, when Congress created the CBI program its intent was to stimulate capital investment in this region so as to utilize Caribbean labor and raw material. Certainly the construction of complete ethanol facilities capable of truly transforming CBI raw materials into ethanol is a worthy policy goal and wholly in keeping with the spirit and letter of the CBI program. However, the assembly of a dehydration facility to act as a dryer of Spanish or Brazilian produced ethanol is simply a clever attempt to circumvent the U.S. duty on foreign produced ethanol without providing any meaningful benefit to the CBI.

If the ruling is not revoked or reversed as to all future dehydration facilities, the Congress will have permitted the CBI to become a conduit for funneling Brazilian ethanol into the U.S. in massive quantities and without regard to the U.S. duty on foreign ethanol. If this happens, the rapid proliferation of CBI dehydration facilities will certainly jeopardize the substantial capital investment already made in the U.S. industry. This result would be a tragic consequence given the enormous contribution the domestic ethanol industry provides to our depressed agricultural economy, to high unemployment areas of the Midwest, and to our national energy security.

To summarize, Mr. Chairman, our testimony today has necessarily focused upon the CBI ethanol threat dehydration issue which we consider to be the most immediate threat to our industry. However, we want to make it clear that RFA is equally supportive of this legislation to close all loopholes in our law, whether they be in the tariff schedule, through Customs misclassifications, or in the Generalized System of Preferences, which have allowed ethanol for fuel use to avoid the Congressionally-mandated tariff.

Should the Congress fail to act on this matter and not close these loopholes which allow importers to mislabel their ethanol for industrial purposes but then sell it for fuel purposes, blend their ethanol with gasoline then pay only a 1.25 cents per gallon duty as opposed to a 60 cent per gallon duty for the ethanol and allow dehydration facilities to operate in the Caribbean under highly advantageous trade conditions reserved for CBI nations, the domestic ethanol industry and CBI economic development will be severely damaged.

Thank-you

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TO: MR. ERIC VAUGHN, PRESIDENT
RENEWABLE FUELS ASSOCIATION
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REF. YOUR TELEX DATED JAN/30/86 UNFORTUNATELY, I COULD NOT GO TO WASHINGTON, D.C. THIS WEEK. PLEASE ACCEPT THE FOLLOWING LETTER 'TO THE CONGRESS OF THE UNITED STATES OF AMERICA' FOR YOUR COMPLIANCE.

MR. SPEAKER, ELECTED OFFICIALS AND LADIES AND GENTLEMEN:

THIS DAY I AM GIVEN GREAT PLEASURE TO ADDRESS THE SUBJECT OF AZEOTROPIC DISTILLATION (THE DRYING OF ALCOHOL) AND GRASS ROOTS DISTILLATION FACILITIES OPERATING IN QUALIFIED C.B.I. COUNTRIES. THIS MATTER OF DEHYDRATING ALCOHOL HAS BEEN CONTEMPLATED AND STRUGGLED WITH INSIDE MY COMPANY FOR SEVERAL YEARS.

BEING A BUSINESSMAN, I ENGAGED MY TECHNICAL STAFF TO RESEARCH THE FINANCIAL OPPORTUNITIES OF DEHYDRATING NON C.B.I. ALCOHOL IN EL SALVADOR. WE EMPLOYED THE NEWEST TECHNOLOGIES AVAILABLE AND IN SUMMARY ARRIVED AT TWO CONCLUSIONS. THE DRYING OF ALCOHOL WAS EXTREMELY PROFITABLE AND THAT MEETING THE 35 PERCENT VALUE ADDED REQUIREMENTS OF THE C.B.I. WAS NOT ACHIEVABLE GIVEN THE RELATIVE INEXPENSIVE CAPITAL COST REQUIREMENTS FOR A DEHYDRATION FACILITY.

IN ADDITION TO THE ABOVE CONCERNS. I HAD PERSONAL AND NATIONALISTIC RESERVATIONS IN THIS SPECIFIC AREA OF DRYING ALCOHOL.

MY FAMILY HAS BEEN IN THE ALCOHOL BUSINESS FOR OVER TWENTY-FIVE YEARS. WE HAVE STRUGGLED THROUGH MANY ECONOMIC AND POLITICAL PROBLEMS WHICH MANY OF YOU ARE WELL INFORMED OF.

WHEN THE OPPORTUNITY ENTERED THE UNITED STATES ALCOHOL MARKET CA,ME BEFORE OUR COMPANY IN 1983, IT HAS TAKEN SIGNIFICANT EFFORTS AND TIME TO MAKE THE NECESSARY CAPITAL EQUIPMENT IMPROVEMENTS TO MEET OUR PROJECTED ANNUAL EXPORT PROJECTION OF THREE MILLION GALLONS. IN JUNE 1985, WE WERE ABLE TO EXPORT OUR FIRST PRODUCTION TO THE STATES.

WHILE OUR ANNUAL EXPORTATION IS NOT GREAT WHEN COMPARED TO THE UNITED STATES CONSUMPTION, IT HAS TAKEN BOTH ECONOMIC AND HUMAN SACRIFICE TO MAKE OUR EXPORTS POSSIBLE. OUR PRODUCTION PROVIDES MANY JOBS TO EL SALVADOR FROM THE WORKER IN THE SUGAR CANE FIELDS TO THE PORT PERSONAL AND THOUSANDS IN BETWEEN.

ECONOMIC NECESSITY HAS PROVEN SALVADOREANS TO BE A RESOURCEFUL PEOPLE. 8WE UTILIZE WHEREVER POSSIBLE EXISTING DOMESTIC INFRASTRUCTURES TO MEET OUR OBJECTIVES. I BELIEVE DEHYDRATION PLANTS HERE IN EL SALVADOR OR ANY SUGAR PRODUCING COUNTRY WOULD FIRST DRAIN DOMESTIC PRIVATE CAPITAL FROM OTHER DOMESTIC INVESTMENTS AND UTILIZE EXISTING STORAGE AND TRANSPORTATION FACILITIES, THUS BRINGIMG ADDITIONAL EXPENSES TO BOTH EXISTING AND FUTURE GRASS ROOTS DISTILLATION FACILITIES. I WOULD LIKE TO SUGGEST TMAT SUCH DEHYDRATION FACILITIES IN EL SALVADOR WOULD CREATE AN AVOIDANCE RATHER THAN INCENTIVIZE THE CONSTRUCTION OF ADDITIONAL GRASS ROOTS FACILITIES.

EL SALVADOR CURRENTLY HAS IN PLACE MANY SUGAR MILLS THAT CAN AND SHOULD BE PRODUCING ALCOHOL AND THE PRIVATE SECTOR IS TRYING TO DEVELOP THIS RESORCE WITHIN A SCALE OF ECONOMY THAT WILL BE PROFITABLE IN A FREE ENTERPRISE SYSTEM.

IN RESPECT OF EL SALVADOR, OUR SHORT AND LONG-TERM ECONOMIC DEVELOPMENT IS DEPENDENT UPON ABILITIES TO UTILIZE WHEREVER POSSIBLE EXISTING CAPITAL ASSETS IN THE CREATION OF TRADITIONAL AND NON-TRADITIONAL EXPORTS.

A DEHYDRATION FACILITY DOES NOT EMPLOY A FRACTION OF THE COUNTRY,'S DOMESTIC CAPITAL ASSETS AND JOBU THAT A GRASS ROOTS FACILITY DOES.

EL SALVADOR AND OTHERNC..I. COUNTRIES MUST DEVELOP DOMESTIC ECONOMIES AND WEA#LTH THAT CAN SURVIVE AND GROW AFTER THE EXPIRATION OF THE C.B.I. PROGRAM WAS PASSED INTO LAW.

THE C.B.I. PROGRAM HAS PROVIDED A NEEDED OPPORTUNITY FOR MY COUNTRY TO CREATE INVESTMENT. TRADE. AND REAL ECONOMIC DEVELOPMENT AND GROWTH.

WE MUST RESIST SHORT TERM OPPORTUNITIES THAT CIRCUMVENT THE NECESSARY DOMESTIC DEVELOPMENT THAT CAN AND WILL PROVIDE INDEPENDENCE IN A DEMOCRATIC FREE MARKET SYSTEM.

THANK YOU FOR YOUR TIME AND THOUGHTS IN THIS MOST IMPORTANT MATTER BEFORE YOU. KINDEST REGARDS, RICARDO H. KRIETE.

SINCERELY,
RICARDO H. KRIETE, PRESIDENT
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COMPARISON OF CBI PARTIAL PROCESS
VS.
"GRASS-ROOTS" ETHANOL PRODUCTION

(based upon a 20 million gallon per year facility)

	Partial Process	Full Grass-Roots
CBI Sugar Used as Feedstock	0	125,000 tons/yr.
Capital Investment	$3.5-5 Million	$35 Million
Construction Jobs	45	375
Permanent New Production Jobs	28	110
Labor Multiplier	Negligible	Substantial
Effect on Stability of Region	None	Positive

(based upon 300 million gallons per year industry)

	Partial Process	Full Grass-Roots
CBI Sugar Used as Feedstock	0	1,900,000 tons/yr.
Capital Investment	$50 Million	$600 Million
Construction Jobs	600	5,000
Permanent New Production Jobs	400	2,000
Labor Multiplier	Negligible	Substantial
Effect on Stability of Region	None	Positive

PLANNED FUEL ETHANOL DEHYDRATION IN CBI COUNTRIES
FOR EXPORT INTO THE US (1.000 GL)

CBI COUNTRIES	1986 DEHYDRATION CAPACITY	 FERMENTATION CAPACITY
Anguilla	-	-
Antigua	-	-
Aruba	50.000	-
Bahamas	-	-
Barbados	12,000	-
Belize	-	-
Cayman Islands	-	-
Costa Rica (2 plants)	25.000	19.000 *
Dominica	-	-
Dominican Republic	50.000	23.000
El Salvador	-	9.510 *
Grenada	-	-
Guatemala...........................	-	8.800 *
Guyana	-	-
Haiti	-	-
Honduras	-	-
Jamaica	50.000 *	-
Montserrat	-	-
Netherlands Antilles	-	-
Panama	-	-
Saint Christopher-Nevis	-	-
Saint Lucia	-	-
Saint Vicent	-	-
Suriname	-	-
Trinidad and Tobago	-	-
Turks & Caicos Islands	-	-
Virgin Islands (4 plants)	115,000	-
TOTAL CAPACITY (CBI)	302,000	60.310

* Already Built, in Jamaica only 20 MGY out from 50 MGY
Individual Companies not identified to protect confidentiality
SOURCE: Information Resources Inc., Washington DC

ETHANOL PRODUCTION POTENTIAL FROM SURPLUS LAND AVAILABLE IN C.B.I. COUNTRIES

Country	(A) Land Area (1,000 Ha)	(B) Arable Lands (1,000 Ha)	(C) Land under Permanent crops (1,000 Ha)	(D) Surplus land available (1,000 Ha)	Cane Yield (1,000 MT) (a)	Ethanol Production (000 gl) (b)
Costa Rica	5,066	283	207	76	5,320	85,120
El Salvador	2,072	560	165	395	27,650	442,400
Guatemala	10,843	1,485	356	1,129	79,030	1,264,480
Honduras	11,184	1,565	199	1,366	95,620	1,529,920
Panama	7,599	462	118	344	24,080	385,280
Subtotal	36,764	4,355	1,045	3,310	231,700	3,707,200
Jamaica	1,083	205	60	145	10,150	162,400
Dominican Republic	4,838	885	350	535	37,450	599,200
Subtotal	5,921	1,090	410	680	47,600	761,600
TOTAL	42,685	5,445	1,455	3,990	279,300	4,468,800

Notes: (a) 1 Ha can produce 70MT of sugar cane
(b) 1MT of sugar cane yields 16 gallons of ethanol

SOURCE: Information Resources Inc., Washington, D.C. and Food and Agriculture Organization of the United Nations, FAO Production Yearbook, vol 36

SURPLUS LAND UTILIZATION & ETHANOL PRODUCTION	
10%	446,880
20%	893,760
50%	2,234,400

Chairman GIBBONS. I am going to ask you some questions about that private ruling because you seem to know something about it. Let's go ahead with the rest of the panel.

The next witness is Mr. Carey.

STATEMENT OF DENNIS J. CAREY, JR., CHAIRMAN OF THE BOARD, PEERLESS OIL & CHEMICALS, INC., AND PEERLESS PETROCHEMICALS, INC.

Mr. CAREY. Thank you, Mr. Chairman.

We would like to submit the written statement.

Chairman GIBBONS. Certainly. Go right ahead.

Mr. CAREY. I would like to explain our particular operation. Peerless is a company doing business in the Commonwealth of Puerto Rico. We have been active there for 30 years in the petrochemical business.

We built the plant in 1966 to process chemicals based on petroleum feedstocks. We revamped that plant in 1976. We shut it down in 1981 due to the vagaries of the petroleum industry and decontrol. Since that time we have operated a portion of the facility as a chemical terminal.

The past few years we have been examining the possibilities of ethanol production from feedstocks produced in the Caribbean area. We have completed all engineering and we are in the process of commencing construction on a full scale ethanol plant designed to process approximately 200,000 tons of molasses and produce 15.5 million gallons of dry ethanol, 200 proof ethanol, to be shipped into the United States for fuels ethanol market.

Our plant, as it exists, represents an investment of $10 million. We will be expending about $7 million more to produce a continous fermentation program, a bit of innovation since most fermentation are of a batch nature. Ours is a process license from a Swedish corporation.

There are four existing plants throughout the world, one in Australia, Pakistan, Brazil, Sweden, one under construction in France. The facility thus will be a full scale operation.

We will be importing feedstocks from other nations in the form of molasses. We have a bulk facility to handle molasses. We are the state-of-the-art fermentation process, distillation, drying. We do not have a market for the dry distillers grains as the stateside plants which would be transferred into animal feedstocks and grains.

There is not such an outlet in Puerto Rico so we have an additional cost in that we have to land farm distillage to conform with EPA regulation for disposal of waste, nonhazardous wastes.

The plant in its construction phase will employ approximately 200 people. During operation there will be 80 people on a full scale payroll. This is on the south coast of Puerto Rico which is an extremely depressed area. The Commonwealth of Puerto Rico has an overall unemployment rate of 25 percent, however, in some areas such as ours the unemployment rate is 50 percent.

The area at one time was a large petrochemical complex comprised of plants from Union Carbide, Commonwealth Refining, and others, which have shut down so it is a depressed area economically. This will be the only operating plant in the area which is in the vicinity of Puerto Rico's second largest city.

Needless to say, the plant has the full support of the Puerto Rican Government since it will represent a multiple factor in the area of four for every employed individual. This plant is greatly exposed economically to a simple drying facility in which as has been pointed out, there is only one fraction of the total process. However, we in Puerto Rico have stateside costs.

We have the same costs as someone has in Illinois, Indiana, Louisiana. We have to abide by EPA regulation. We have the same wage scale as exists on the U.S. gulf coasts.

We have the disposal situation which has to be very carefully handled to conform with the pollution regulation existing in Puerto Rico. We also have the additional necessity of shipping our product to the United States in American flagships, an advantage which we do not have compared to the offshore, non-United States Caribbean oil and/or Caribbean countries.

Therefore, we feel greatly exposed in this investment which will be on the order of $17 million competing against someone on what has been described as an unlevel playing field. Therefore, we heartily endorse this regulation and we feel that it is absolutely necessary if plants like ours are to survive.

We feel we do meet the full requirement and the philosophy of the CBERA in that we will be furnishing employment for those who grow the feedstock. We will process the feedstock, handle it, manufacture it, and come up with pure ethanol to be shipped into the U.S. market.

That essentially is our situation and that is the basis for our support of this legislation. Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF DENNIS J. CAREY, JR., CHAIRMAN OF THE BOARD, PEERLESS OIL & CHEMICAL, INC. AND PEERLESS PETROCHEMICALS, INC.

Peerless Oil & Chemicals, Inc. ("Peerless") would like to offer testimony in support of H.R 1720, which denies duty-free access for ethanol that is merely distilled and dehydrated in a Caribbean Basin Initiative country.

Peerless, a privately owned corporation which has been on the island of Puerto Rico for over thirty years, owns a processing facility in Puerto Rico, currently valued at over ten million dollars. At the present time, Peerless is in the construction phase of revamping existing distillation equipment, and adding new fermentation equipment to its Puerto Rican facility. This additional investment, which will allow Peerless to process sugar based feedstocks from the island as well as C.B.E.R.A. nations, will exceed seven million dollars. This investment represents an upgrading to state of the art processing design. A continuous fermentation section (as compared to batch fermentation) has been included in the process train giving Peerless the capability of handling a variety of liquid feedstocks with great efficiency and minimum heat requirements. Initially, the plant will be processing molasses, but could be used to process Puerto Rico based bio-mass feedstocks currently under development by the government of Puerto Rico.

Peerless made its decision to revamp its facilities for alcohol production based upon the following considerations:

A. The production of alcohol maximizes corporate knowledge and experiences, as Peerless has been in the petroleum and chemical processing sector for over thirty years.

B. All the arguments made in support of Ethanol production from grain in the continental United States apply with equal or greater emphasis with regard to production from sugar based feedstocks in Puerto Rico. The Commonwealth of Puerto Rico is a vital part of the entire U.S. economic, political and military structure.

C. Puerto Rico, with its geographical location in the Caribbean, is a key factor in the success of the C.B.E.R.A.

D. The current economic environment including reliance on incentives provided in U.S. government programs, existing tariffs and the EPA lead phase down.

Peerless' facility, when completed, will represent an investment in excess of $20 million. The manufacturing process will include the receipt of bulk feedstocks, fermentation, rectification, dehydration, and denaturing prior to the shipment of the finished product to the continental United States.

At this time the market for the Puerto Rican produced fuel grade Ethanol is the continental U.S., and Peerless must transport its processed material by American flag vessel pursuant to the provisions of the Jones Act.

The C.B.E.R.A. provides tariff-free treatment on products (1) grown, produced, or manufactured (including substantial transformation) in a qualified beneficiary country; (2) directly imported into the United States; and (3) which, at importation, contain at least 35 percent of the product's appraised value resulting from materials and direct processing costs originating in the beneficiary country.

Congress crafted the C.B.E.R.A., to provide one-way free trade with "the most favorable and secure long term access possible to the U.S. market." 1983 U.S. CODE CONG. & AD. NEWS 643, 644 (H. Rep. No. 266, 98th Cong. 1st Sess.). It intended to assist C.B.E.R.A. beneficiary countries establish a capitalistic industrial base. The C.B.E.R.A. legislative history, in this regard, clearly evidences that Congress intended tariff-free treatment on qualified beneficiary country products directly imported into the United States to counter "serious inflation, high unemployment, declining gross domestic product growth, enormous balance of payments deficits, and pressing liquidity crises". Id. The benefits which will accrue to C.B.E.R.A. beneficiary countries through the Peerless' Puerto Rico facility as an outlet for molasses production clearly comport with the spirit of this Federal trade legislation.

Peerless is heartily in favor of the C.B.E.R.A. intent as stated above. However, in 1984, the U.S. Customs Service ruled that hydrous ethanol brought into the Caribbean and upgraded to fuel grade anhydrous ethanol qualifies for duty-free access to the United States under the Caribbean Basin Initiative. Pursuant to this ruling alcohol from around the world can be imported duty-free to the United States as long as the alcohol has been upgraded by dehydration and denaturing in a CBI country. This position has recently been confirmed by the U.S. Customs Service in a response to a petition filed by the National Corn Growers Association. This response of Customs appears contrary to the C.B.E.R.A. intent.

As a Congressional response, Representatives Durbin, Daschle and Bedell have introduced H.R. 1720 which amends the Caribbean Basin Economic Recovery Act (19 U.S.C. 2703) by providing that no ethanol will be eligible for duty-free treatment merely by virtue of having been subjected to a distillation process within a Caribbean country.

Peerless agrees with Representatives Durbin, Daschle and Bedell because:

1. The investment of a drying facility, when compared to a U.S. full fermentation plant is minimal, therefore, justification of the 35% value added requirement is difficult.

2. When comparing a drying facility to a full fermentation plant processing a feedstock grown and produced within the CBI country, the amount of personnel employed in the drying facilities is small.

3. The alcohol is imported into the CBI country and thus the CBI nation loses the ability to generate revenue through the sale of its own products by the replacement of the molasses produced within the CBI nation by the imported alcohol, product of a Non CBI country.

CBI was designed to create the incentives required to generate funds by promoting the production and export of indigineous Caribbean products. As stated before, the C.B.E.R.A. provides tariff-free treatment on products (1) grown, produced, or manufactured (including substantial transformation) in a qualified beneficiary country; (2) directly imported into the United States; and (3) which, at importation, contain at least 35 percent of the product's appraised value resulting from materials and direct processing costs originating in the beneficiary country.

Peerless' current and proposed operations are located in an area of Puerto Rico comprised of high unemployment, resulting from multiple plant closings in recent years (e.g., Union Carbide, PPG Chemicals, Commonwealth Oil Refining). Peerless' facility will constitute the only operating plant remaining active in an area once known as "the Guayanilla Petrochemical Complex". The Company's employment of currently unemployed skilled labor for operating and construction activities at this proposed facility will directly benefit this economically depressed area. Its large volume purchases of sugar based feedstocks, similarly will provide direct and immediate economic aid to neighboring C.B.E.R.A. beneficiary countries.

Peerless will not primarily produce alcohol from corn. Rather, Peerless will produce alcohol by fermentation from molasses grown in the Caribbean basin. Therefore, we would like to join with the U.S. sugar growers, corn growers and full scale alcohol producers in expressing our support for H.R. 1720. As a user of Caribbean products, we would like to point out that the purposes of H.R. 1720 are entirely consistent with the legislative objectives of the Caribbean Basin Initiative (CBI).

We believe that growers and suppliers of Caribbean cane products will be seriously injured by this loophole which allows duty-free importation of non-CBI alcohol. Therefore, as a company that is actively engaged in purchasing and processing sugar derived products grown and made in the Caribbean, we urge Congress to adopt H.R. 1720. If this loophole is not closed, an important market for Caribbean products (i.e., sugar-based ethanol production) will be eliminated, and plants such as ours, vital to the Puerto Rican and other CBI economies will be rendered un-economic, and areas other than the CBI and the entire agricultral U.S. will be benefiting from this ill-advised policy.

Chairman GIBBONS. Thank you.

Mr. Carey, are you any kin to Hugh?

Mr. CAREY. He is my little brother.

Chairman GIBBONS. I looked out there and I thought you all looked alike.

Mr. CAREY. I don't know whether to be flattered or not, but thank you.

Chairman GIBBONS. I am a great admirer of Hugh Carey and I'm glad to meet you, Mr. Carey. I had the privilege of sitting next to him for about 10 years here in Congress. I know what a bright, fine person he is.

Mr. CAREY. Thank you, sir. I will convey that sentiment. I am sure he will be very appreciative.

Chairman GIBBONS. Mr. Perez.

STATEMENT OF ROLANDO ARIEL PEREZ, VICE PRESIDENT AND MANAGER, LATIN AMERICAN SUGAR DEPARTMENT, E.F. HUTTON & CO., INC.

Mr. PEREZ. Thank you very much. My name is Rolando Ariel Perez. I am vice president and manager of the Latin American sugar department of E.F. Hutton & Co. In this capacity, I serve as the sugar marketing adviser in eight Caribbean and Latin American nations, including four governments. The amount of sugar exported from the Caribbean Basin Initiative countries is approximately 31 percent of all sugar grown and exported in Latin America, excluding Cuba. My purpose today is to urge the favorable consideration of legislation to exclude from the Caribbean Basin Economic Recovery Act, CBERA, ethyl alcohol used for fuel which is merely distilled or denatured in a beneficiary country. As an investment bank which is involved in the CBI region in sugar, the reason we support H.R. 1567 is that it is very difficult to economically justify investments in full scale ethanol plants as long as the ability exists for dehydration facilities to qualify for CBERA treatment.

The importance of sugarcane on the economies of Caribbean nations cannot be overstated. The sugar industry is a major cash crop, a major source of exports and, as a result, a primary source of local employment, economic activity and political stability. Because of the current worldwide oversupply of sugar and the U.S. sugar quota system, I believe it is extremely important for my client nations to explore aggressively the development of new markets and new uses for their sugarcane. To do otherwise would compel the consideration of additional sharp cutbacks in production and the painful social and economic dislocation that accompany such decisions.

Obviously, the conversion of sugarcane into fuel ethanol is a subject that many Caribbean nations should carefully evaluate. Indeed, some are already in the midst of developing this industry, such as El Salvadore. Such development provides important alternative markets and increased demand for sugarcane. In addition, the construction of full-scale fermentation and distillation complexes provide capital investment and much needed new jobs.

The CBERA provides incentives to develop new industry in the Caribbean Basin. The duty-free importation of fuel ethanol produced in CBI nations gives my clients access to the growing U.S. market for lead-free octane enhancers. Unfortunately, the Customs Service's interpretation of the CBERA provisions relating to the "substantial transformation test" has had a chilling effect on the development of this new industry in the Caribbean Basin. By ruling that ethanol which merely undergoes azeotropic distillation in the Caribbean satisfies the substantial transformation rules of the CBERA, the Customs Service has sanctioned a tremendous loophole that works against the CBI nations that desire to attract new capital expenditures and develop long-term markets for their sugarcane.

The capital costs needed to construct a full-scale fermentation and distillation complex similar to the one in El Salvador exceed by many times the costs of simple dehydration facilities similar to the facilities that has prompted the introduction of H.R. 1567. By acting as a simple reprocessing site for ethanol produced in other parts of the world, these types of dehydration facilities preclude the utilization and processing of CBI sugarcane. Indeed, the economic realities are so overwhelming that it is my judgment that unless legislation to close this loophole is enacted, many of the promising new investments in the CBI ethanol industry will never be realized.

I therefore urge the enactment of H.R. 1567. Thank you for this opportunity.

Chairman GIBBONS. Thank you, sir.

National Corn Growers Association.

STATEMENT OF GEORGE ANSELM, VICE PRESIDENT, GOVERNMENT RELATIONS COMMITTEE, ACCOMPANIED BY HAROLD CUTLER, VICE PRESIDENT, NATIONAL CORN GROWERS ASSOCIATION

Mr. ANSELM. Yes. Thank you very much. I think our testimony has been submitted and I will——

Chairman GIBBONS. We will put it in the record.

Mr. ANSELM. My name is George Anselm, the vice president of Government relations of the National Corn Growers Association and a corn and hog farmer from Taylorsville. The members of our organization appreciate having the opportunity to testify before the House Ways and Means Trade Subcommittee this morning.

The National Corn Growers Association is a nonprofit, nonpartisan organization which represents the Nation's 1.3 million corn farmers. The purpose of our organization is to enhance and expand the use, marketing, and efficient production of American corn.

Since 1978, a substantial fuel ethanol industry has developed in the United States which uses corn as its primary feedstock. The Corn Growers and its members are therefore vitally interested in the continued growth and viability of this industry. As the fuel ethanol market has grown, so has the amount of corn used as the feedstock to produce the fuel ethanol. That is the one ray of good news for the American farmer, who has seen exports slump, market prices drop and domestic surpluses grow as the result of depressed markets abroad.

As recently as 1980 only 15 bushels of corn were used in the ethanol process. In 1985 the consumption was more than 240 million bushels. We have set a goal of increasing the amount of corn used in domestic fuel ethanol production to 1 billion bushels by 1990. That 1 billion bushels, and I think this is very very important to get across, is that it is equal to the amount of surplus corn that has been produced annually in the past few years.

If our goal is reached, the American farmer will be among many who will reap the benefits. The importance of the continued growth of the domestic fuel ethanol industry to the American farm community in perspective, a study completed by the General Accounting Office in 1984 concluded that production of 1 billion gallons of fuel ethanol annually by 1990 would generate a net farm income of some $3.6 billion. In addition, the increased use of corn as a fuel ethanol feedstock will help deplete the 3 billion bushels of surplus corn currently stockpiled in the Nation's grain elevators.

Certainly it will also greatly add to the economy of the rural areas by creating jobs for the production of new plants, and also for the other feed stuffs that go into the agriculture production. Today the U.S. corn industry and corn growers are at a crossroad. Put bluntly, many corn growers are struggling to survive. Given the all-time record corn harvest in 1985, farm gate prices of corn below the cost of production, corn surpluses approaching near-record levels, and export volume diminishing, the development and expansion of new markets such as fuel ethanol are of tremendous importance to the health and viability of the U.S. corn industry.

Demand for ethanol/gasoline blends is substantial in many midwestern States. Over 30 percent of the gasoline sold in Iowa, for example, contains ethanol. Markets for ethanol production coproducts are also growing rapidly. All the necessary geographic factors for a profitable ethanol industry are also available at many midwestern locations. However, imported ethanol and highly subsidized foreign production facilities and feedstocks continue to be a deterrent to the development of many domestic proposed plants.

I have listed here several reasons why ethanol is having an adverse impact on new and proposed ethanol plant. One, the rapid increase in imported ethanol, 5 million gallons in 1981 to more than 100 million gallons in 1985, causes potential project financiers concern about uncontrolled imports.

Project financiers have also expressed concern about the price of imported ethanol. Due to price undercutting, imports often displace domestic ethanol. Financiers are justifiably concerned about capitalizing projects which must complete with projects and feestocks subsidized by the Brazilian Government.

Circumvention of tariffs has also resulted in artificially low priced ethanol. By avoiding tariffs, importers can easily undercut the price of domestically produced ethanol. The specter of continued supplies of low cost ethanol in midwestern markets makes it extremely difficult to attract financial support to proposed ethanol projects.

The CBI initiatives is being used to encourage development of a foreign ethanol industry at the expense of domestic development.

Recent Customs Service rulings incorrectly explain that 200 proof alcohol is a "new and different article of commerce" when compared to 190 proof ethanol.

If I could, I would like to quote from Mr. Vaughn's testimony which he did not read into the hearing this morning, but it is a quote from a leading Brazilian ethanol producer who recently testified before the International Trade Commission, and "I can produce anhydrous ethanol or hydrous. The difference is so small I always produce anhydrous because the cost is smaller, storage is smaller and every time someone wants to buy hydrous ethanol, I just add water. It is as simple as that."

If unfairly traded, imported fuel ethanol displaces domestic production, thereby reducing demand for corn with a consequent reduction in corn prices. I would remind you that the American agricultural community employs one in every five Americans. If corn growers lose money and drop out of the economy, a significant number of Americans suffer.

For all of these reasons, the National Corn Growers Association stands firmly in support of the American Fuel and Ethanol industry and the continued expansion and development of this vitally domestic corn market.

Again, I thank you for the opportunity to testify here this morning.

[The prepared statement follows:]

STATEMENT OF GEORGE ANSELM, VICE PRESIDENT, GOVERNMENT RELATIONS COMMITTEE, NATIONAL CORN GROWERS ASSOCIATION

Good morning. I am George Anselm, the Vice President of Government Relations of the National Corn Growers Association (NCGA), and a corn farmer from Taylorsville, Illinois. The members of our organization appreciate having the opportunity to testify before the House Ways and Means Trade Subcommittee this morning.

The National Corn Growers Association is a nonprofit, non-partisan organization which represents the nation's 1.3 million corn farmers. The purpose of our organization is to enhance and expand the use, marketing, and efficient production of American corn.

Since 1978, a substantial fuel ethanol industry has developed in the United States which uses corn as its primary feed-stock. The Corn Growers and its members are therefore vitally interested in the continued growth and viability of this industry. As the fuel ethanol market has grown, so has the amount of corn used as the feedstock to produce the fuel ethanol. That is the one ray of good news for the American farmer, who has seen exports slump, market prices drop and domestic surpluses grow as the result of depressed markets abroad.

To say the fuel ethanol market has become extremely important to American farmers who supply corn for ethanol production is an understatement. As recently as 1980, only 15 million bushels of corn were used in the fuel ethanol process. In 1985 the estimated consumption of corn to produce fuel ethanol was more than 240 million bushels. The Corn Growers have set a goal increasing the amount of corn used in domestic fuel ethanol production to 1 billion bushels by 1990. That 1 billion bushel goal is about equal to the amount of surplus corn that has been produced annually in recent years. If our goal is reached, the American farmer will be among many who will reap the benefits.

To put the importance of the continued growth of the domestic fuel ethanol industry to the American farm community in perspective, a study completed by the General Accounting Office in 1984 concluded that production of 1 billion gallons of fuel ethanol annually by 1990 would generate a net farm income of some $3.6 billion. In addition, the increased use of corn as a fuel ethanol feedstock will help deplete the 3 billion bushels of surplus corn currently stockpiled in the nation's grain elevators. A stronger, more stable market for corn will put more money into the hands of our financially strapped farmers, and the rural economy will be strengthened by their increased purchasing power. In this regard, I would remind you that every dollar a farmer spends generates an additional $7 in the economy. In the wake of that ripple effect, new jobs are created and the tax bases of our devastated rural communities are enhanced. At the urban level, the economies of our cities with ties to American agriculture would be stimulated by the revived economies in our Farm Belt.

So, today, the United States corn industry and corn growers are at a crossroad. Put bluntly, many corn growers are struggling to survive. Given the all-time record corn harvest in 1985, farm gate prices of corn below the cost of production, corn surpluses approaching near-record levels, and export volume diminishing, the development and expansion of new markets such as fuel ethanol are of tremendous importance to the health and viability of the U.S. corn industry.

Demand for ethanol/gasoline blends is substantial in many midwestern state. Over 30 percent of the gasoline sold in Iowa, for example contains ethanol. Markets for ethanol production co-products are also growing rapidly. All the necessary geographic factors for a profitable ethanol industry are also available at many midwestern locations. However, imported ethanol and highly subsidized foreign production facilities and feedstocks continue to be a deterrent to development of many domestic proposed plants. Following are several specific reasons why imported ethanol is having an adverse impact on new and proposed ethanol plant:

(1) The rapid increase in imported ethanol (5 million gallons in 1981 to more than 100 million gallons in 1985) causes potential project financiers concern about uncontrolled imports. Despite a significant increase in the tariff on imported ethanol, the annual volume of imports has been increasing. In many markets, imported ethanol undercuts the price of domestically produced ethanol.

(2) Project financiers have also expressed concern about the price of imported ethanol. Due to price undercutting, imports often displace domestic ethanol. Financiers are justifiably concerned about capitalizing projects which must compete with projects and feedstocks subsidized by the Brazilian government.

(3) In several regional markets, including Nebraska, ethanol plants have discontinued production. In many cases, production has been halted because of depressed ethanol prices caused, in part, by low cost imported ethanol which has circumvented the 60 cent per gallon duty.

(4) Circumvention of tariffs has also resulted in

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artificially low priced ethanol. By avoiding tariffs, importers can easily undercut the price of domestically produced ethanol. The specter of continues supplies of low cost ethanol int midwestern markets makes it extremely difficult to attract financiers to proposed ethanol projects.

(5) The CBI initiatives is being used to encourage development of a foreign ethanol industry at the expense of domestic development. Recent Customs Service ruling incorrectly explain that 200 proof alcohol is a "new and different article of commerce" when compared to 190 proof ethanol. While there is a modest increase in the value of such upgraded ethanol, there is certainly not a "new or different article of commerce" which results from this process as defined by earlier rulings.

If unfairly traded, imported fuel ethanol displaces domestic production, thereby reducing demand for corn with a consequent reduction in corn prices. This will seriously disrupt the existing market and cause substantial and irreparable harm to corn farmers and related sectors of the corn industry. This reduction in corn use would mean lost sales worth millions of dollars and a lower price for the billions of bushel of corn used. I would remind you that the American agricultural community employs one in every five Americans. If corn growers lose money and drop out of the economy, a significant number of Americans suffer. The ripple effect extends to seed and chemical suppliers, equipment manufacturers, transportation workers and all the other people who rely on the American corn economy for their livlihood.

For all of these reasons, the National Corn Growers Association stands firmly in support of the American Fuel and Ethanol industry and the continued expansion and development of this vitally domestic corn market.

We appreciate having this opportunity to appear before you today, and will attempt to answer any questions that you may have about our testimony.

Chairman GIBBONS. You mentioned something about a private ruling, Mr. Vaughn. Would you go over that again?

Mr. VAUGHN. The Customs Service ruling?

Chairman GIBBONS. Yes, sir.

Mr. VAUGHN. In September 1984 Customs Service granted a private letter ruling to Tropicana Oil to produce a facility, construct a facility which is essentially a drying column in the Caribbean in Jamaica outside of Kingston at a cost as they have stated in their own testimony of roughly $5 million.

They received that ruling. As we understand it, it is in the record in several statements in the record to the committee last year on the basis that this was a new and different article of commerce, 5 percent removal of water coming out of hydrous alcohol.

Chairman GIBBONS. Is this a new ruling as far as you know?

Mr. VAUGHN. This is the first of its kind out of the Customs Service that I know of. I don't know if you are referring to special letter rulings if they are unusual. They certainly appear to be unusual. There is no opportunity for public comment or reaction to them.

Chairman GIBBONS. Was there anything about the ruling that would arouse your suspicion?

Mr. VAUGHN. I guess I am not certain what you are leading to, sir.

Chairman GIBBONS. Well, you referred to it as an unusual letter ruling or a letter of—a private letter ruling and just from the tone of your voice I felt that there was something that raised a sense of suspicion.

Mr. VAUGHN. I am not sure what you are referring to. By unusual, I don't mean to refer to an illegal action. I mean unusual in that had the opportunity been made available for public comment prior to that letter ruling being issued, we probably could have within the context of the Customs Service argued this point out to determine once and for all whether or not this final removal of 5 percent water was in fact substantial transformation.

The Bureau of Alcohol, Tobacco and Fire Arms has said clearly removing 5 percent water is not substantial transformation, but the Customs Service provided the letter ruling despite that.

Chairman GIBBONS. When did the other folks get mixed up in it? Is that in this same case, or is it a different case?

Mr. VAUGHN. The additional facilities that are coming on line?

Chairman GIBBONS. About the Bureau of Alcohol, Tobacco and Fire Arms, when did they make ruling about 5 percent?

Mr. VAUGHN. They were asked to comment to provide information essentially after the fact to decide whether or not this was in fact substantial transformation or part of the process. I don't have the documentation in front of me, but they have in the past ruled that is not a substantial formation of the product.

Chairman GIBBONS. Who got the ruling?

Mr. VAUGHN. The original ruling in September, Tropicana Oil. I think they are testifying shortly. Mr. Dick Vind is the president.

Chairman GIBBONS. Yes, I see they are going to testify. Was there effort made to challenge the ruling or was there any opportunity to challenge the ruling?

Mr. **Vaughn**. Maybe that is what I am trying to make a point of in terms of an unusual ruling circumstance. When a company goes in before the Customs Service, because of proprietary information or information they don't want revealed to the public for fear that others may come in behind them or in front of them with this idea they go before the Customs Service and ask for a private letter ruling.

So part of this process in many cases the process itself is at fault. We open up for public comment for 30 or 90 days anyone's interest or ability to go out and chop down one tree in a national forest, but we allowed this plan to be built without an opportunity to debate the issue before a ruling was made.

A 20-million-gallon facility built in the United States would cost roughly $60 million, employ 100 people. We allowed that facility to go into operation essentially under everyone's nose and more importantly having the dramatic impact, negative impact in the CBI. To answer your question, no, there was no opportunity for public comment prior to the issuance of that ruling.

Chairman **Gibbons**. How did you find out about the ruling?

Mr. **Vaughn**. I may be off on my dates on this. There was—after the fact, a notice published and made available to the public.

Chairman **Gibbons**. You found out about it then?

Mr. **Vaughn**. Found out about it after the fact. About the end of the year. In the early part of 1985, we began working with Members of the Senate and the House of Representatives to introduce legislation that would shut this loophole after one horse had left the barn to try to at least cap the Customs Service ruling at the one facility.

The problem is in the year since we have seen dozens of similar facilities coming on line, and we have indications from a variety of companies that they have plans to build drying towers in the Caribbean. We could be looking at 240 million gallons of this dehydrated ethanol coming into the country picking up duty-free status and tremendous amounts of revenue outflow in terms of the 60-cent exemption, because they don't pay anything to gain access to that exemption.

Chairman **Gibbons**. Thank you. Mr. Schulze.

Mr. **Schulze**. I have no questions.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman. Gentlemen, thank you for your excellent testimony. That ruling on Tropicana, there was another complaint raised by the corn growers, I believe, with respect to the CBI process, which was not accepted; is that not true?

Mr. **Anselm**. That is right. I believe that is correct.

Mr. **Frenzel**. So there is not just one or maybe they are different and maybe Mr. Vaughn could differentiate or help us with that.

Mr. **Vaughn**. You are referring to a corn grower—I'm sorry, I didn't hear part of the question.

Mr. **Frenzel**. It was my understanding that the corn growers had a protest against a CBI operation in Jamaica, and that their protest was rejected by the Customs Service.

Mr. **Vaughn**. The corn growers and others identified—I don't know the technical terminology, but essentially a petition with the Corn Growers Association asking the Customs Service to review the decision and to overturn it and that was rejected by the Customs Service.

Mr. **Frenzel**. And then the corn growers had another similar request which was not CBI exclusive that was accepted; is that not true?

Mr. **Vaughn**. I think what you are referring to is there is an International Trade Commission ruling underway at the present time. I tried to allude to that, and I apologize for the brevity in my opening statement, but there have been a number of loopholes open in just the last 18 months, and I think the number of loopholes around the tariff for any commodity is something that is relatively unique.

The corn growers have been very active in this effort, to develop the market, to work with the Environmental Protection Agency, the Bureau of Alcohol, Tobacco and Firearms, National Council of Weights and Measures on measuring standards, ASTM; all this effort to expand and develop markets and then imports come into the market, heavily subsidized and aim right for the best developed markets.

There is something very interesting about the way the imports come in. They do not want to pay the tariff, and as the chairman pointed out, a very high tariff, but they want full access to the domestic incentive as the Congress defined the domestic incentive for domestic producers.

Mr. Chairman, I am not sure what my association would say. I am not sure that we have such a strong interest in the 60-cent tariff. If we could find a way to keep the imported product separate from domestic product and keep it away from domestic incentive provided to the domestic industry, we might support getting rid of the tariff.

Mr. **Frenzel**. I think Mr. Vaughn, you would do the subcommittee a favor if you would list all of these, in simple form, all of these ways to get around that tariff. Like the chairman, I was not thrilled when the high tariff was put in. It was done in the dark of night with very little debate, and Congress may have wanted it anyway, and might have accepted it under normal terms.

Now that we have got it, it ought to work. At the same time when you are talking about some of these rulings with respect to Jamaica, those have not been within the last 18 months. They have been ongoing for 5 years, some of these programs—not 5 years, whenever the CBI was put into operation, American companies went to countries like Jamaica trying to follow what they thought was national policy. So I would not describe those as new ways to get around the tariff.

I think we have to differentiate if we can. I think we understand your problem, and we understand your frustration, all the agencies, all the effort and all the time and expense you have got, and we do want our tariffs to stand. Whether we approve of them or not, they are the law.

Mr. **Vaughn**. I tried to identify the different ethanol loopholes in my written comments for the record, but what I was trying to refer to in the last 18 months, ethanol has been blended with a variety of other chemicals. Last year's top 10 list was ethanol and toluline—E.T. fuel it was called. Ethyl benzene is coming in currently, a number of other chemicals added to it, and then these drying facilities, and we in fact lump them all together, if you will, because the legislation attempts to deal with these tariff loopholes which we believe product is being doctored, if you will, or produced simply to circumvent the tariff.

There is no technical reason to import ethanol blended with any other chemical or material other than to circumvent the tariff. There is no reason to bring ethanol 5,000 miles across the ocean in a 95 percent finished product state to stop off in Jamaica to have some water removed and come to the United States, a process that costs 17 cents in Jamaica. And the same process in Brazil or the United States would cost 2 to 3 cents.

It costs 17 cents in Jamaica and there is one reason for it, and that is to escape the tariff. When it arrives in the U.S. ports, there are no discussions whatsoever, over whether or not to take advantage of the domestic ethanol incentives, and ethanol will take advantage of that incentive put in place for domestic producers.

Mr. **Frenzel**. I think the committee would like to discriminate between outright evasion of the tariff and doing things that people thought were legal and told were legal under the CBI operation. I understand that Jamaica is at least considering opening more fields so that one would not have to import there and then do the distillation process; that you would do a good deal greater percentage of the process in Jamaica.

I am not sure that is a good idea because eventually if American producers are more competitive, then those fields will simply go back to producing for the sugar market and all of you, your producers are affected in a lot of ways by that. All this ties together in sweeteners as well as fuels.

Mr. **Vaughn**. Yes, sir. There is no question that Tropicana Oil is an excellent company run very well, and took advantage very wisely, from a corporate standpoint what we would regard as a loophole, but certainly there is a differentiation between a facility——

Mr. **Frenzel**. I think we have to think our way through the various evasions, and you can help us by giving us kind of a comprehensive list.

Mr. **Vaughn**. If I could, I would like to present that to the committee at a later time, and I will provide you with that.

Mr. **Frenzel**. Our record will remain open for about a week, Mr. Chairman?

Chairman **Gibbons**. At least a week, yes.

Mr. **Frenzel**. I am not talking about a complicated footnoted thing. Just a way for us to distinguish between those evasions. I would like to give you and anyone on the panel a chance to rebut the departmental witnesses who were here before you came on, and I presume your testimony was written before they came on.

I think what they said needs discussion. As I recall, their testimony was that your markets were going to be far more affected by the price per barrel of oil and by EPA type regulation for discharges from automobiles than by these things that you were requesting or by the tariff, and, of course, you have answered, I think, some of their other arguments, or at least you have spoken to those questions about the nature of the tariff, about evasions of the tariff, et cetera. But could you address those two points that the administration raised?

Mr. VAUGHN. Yes sir. There is no question that our industry, along with nearly every other renewable energy industry, and our domestic oil producers industry, is being greatly affected by the fall in crude oil prices. As you know, when ethanol first came on the scene it was regarded as a fuel extender, essentially allowing us to extend our critically short supplies of fuel at the time. In the last several years it has evolved, if you will, into a very superior octane enhancing agent.

As an octane enhancer, as we were phasing down and phasing out lead, ethanol's utility in the fuel stream has become greatly enhanced, thus the international interest in ethanol production and import into our markets has increased as the development of the domestic industry. I guess I would describe it in the same way one of our producers described several problems we are facing all at once. It is like your front porch is on fire and the front porch is on fire because you have got ethanol imports coming in, either blended or being dried out in a facility in Jamaica, but you have also got steak burning on the stove and somebody is breaking in your back door. What do you deal with first?

What we are trying to do is deal with all of them at the same time, but with the front porch being on fire, shiploads of ethyl benzine and ethanol coming into the country early next week, we decided we need to focus our attention on this very serious issue. I think I would like to point out to any officials of the administration that when you look around at the domestic ethanol industry, nearly $2 billion have been invested in private resources in this industry. This is an industry that was established because the government said we need alternative fuels with an energy shortage which suddenly seems to have evaporated.

We also need this industry to be there to help us deal with the surplus grain problem. Both of these issues are very effectively addressed by a solid commitment in this industry. But I would say at this point, with our front porch on fire, if we don't want the house to burn down, we have got to stop these imports.

We will address the oil price fall the same way everyone else will. We will have to become more competitive and aggressive and I think we will be able to do that.

Mr. FRENZEL. Your description reminds me of a departed member of our committee, who used to say often we were swatting flies on the front porch despite the fact that there were lions and tigers in the kitchen. But in recalling that, I also have to recall he formulated the law that said anyone who asked excessive questions on Friday would lose their library card, so I am going to yield back.

Chairman GIBBONS. It is my impression that Outboard Marine has put out a warning to all outboard manufacturers to not put any of this in their motors, that warranties don't extend to this stuff. I know I am very careful when I fuel my outboard motor to make sure that there is no ethanol in the fuel because it violates the warranty on the motor, as I understand it.

Mr. VAUGHN. Mr. Chairman, if I could address that very briefly, there can be a problem when you put ethanol into a small outboard motor with lots of rubber hoses. Not in the operation of the engine, which has been proven with countless tests—and I am sorry I don't have that material with me today, but I will certainly make it available to you personally, or the committee. The operation of ethanol on a small outboard motor has absolutely no problem.

A problem can occur in outboard motors when people store their boats for the winter, put it up on the hoist or on the rack. I know myself I am careless with my boat. I don't drain the fuel tank, drain the hoses, and flush those hoses off. If you leave it sitting for 6, 7, 8, 9 months, fuel of any kind will begin to eat through the seal.

Chairman GIBBONS. The ethanol eats the seals?

Mr. VAUGHN. If it sits there for 8, 9, 10 months, without anything moving, it is my understanding that any fuel will speed the corrosion of seals and hoses. The boating market for fuel is such that one of the reasons we were very aggressive and out front with fuel labeling laws—we have encouraged every State that uses ethanol to identify clearly 10 percent ethanol in their product principally for boaters. But from an operational standpoint, there are virtually no problems.

Chairman GIBBONS. I am concerned—it is not germane to this hearing, but I am concerned about it because I read somewhere I think that some boater has been badly burned by not being aware of this and the seals had leaked and there was an explosion, and that concerns me from a public safety point of view.

Mr. VAUGHN. It concerns us as well, from both a public safety standpoint, but also marketing standpoint. I believe that was an accident that as people have looked into it, have found it was not ethanol that was being blended in the fuel but an overblending of methanol that comes from natural gas or coal. In fact, I have seen a demonstration, it is against the fire laws I am sure of the Congress—but I have seen a pan of ethanol, methanol and of gasoline, and if you light a match to the gasoline, it will explode. And methanol, a little smoke, and with ethanol, the flame is like what you would see in some small flame or something.

Ethanol is not anywhere near as flammable or as dangerous a liquid to use anywhere as much as gasoline. The explosion did not occur as a result of ethanol.

Chairman GIBBONS. I am glad to hear that. If you have any more publications, I would be happy to have those personally.

Mr. VAUGHN. Yes sir.

Chairman GIBBONS. I don't have any questions.

Any questions of the panel?

Thank you very much.

Mr. Carey, please tell your brother hello for me.

Our last formal panel, Tropicana Petroleum, Ltd., Chemical Fuels Corp., RAJ Chemicals, Inc., and Caribbean/Central American Action. If we could have all of those come forward, please.

Mr. Vind seems to be the first one.

STATEMENT OF RICHARD B. VIND, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TROPICANA PETROLEUM, LTD.

Mr. VIND. Mr. Chairman, would it be possible if I could hand to you some pictures of our facility, along with a rather detailed——

Chairman GIBBONS. Sure. I notice there are some attached to your statement, but photographs are photographs.

Mr. VIND. I have some color photographs of our plant, if I might.

Chairman GIBBONS. We will be happy to receive them. We will be happy to look at them while you are speaking.

Mr. VIND. In addition to the pictures themselves, I have included a very detailed presentation by the Butler Research and Engineering Firm, which outlines the extensive amount of planning and detail.

Chairman GIBBONS. You are the fellow everybody is complaining about, is that right?

Mr. VIND. I am the guy.

There are 98 pages of process standards, 13 pages of job descriptions, 12 pages of engineering drawings and 22 pages of parts lists included with the Butler report. For the record, I would like to ask the chairman—we have submitted written comments—if you would accept those.

Chairman GIBBONS. Yes sir, they will all be included in the record.

Mr. VIND. Thank you very much.

My name is Richard B. Vind. I am President and Chief Executive Officer of Tropicana Energy Company and its affiliate, Tropicana International of Jamaica.

Chairman GIBBONS. Let me ask you a question right there. I always thought Tropicana was an orange juice. Are you then——

Mr. VIND. We are not affiliated in any way with Beatrice Foods, no sir. We are a small privately owned ethanol and gasohol distribution marketing company which owns and operates gasohol blending terminals in Fort Worth, Texas, Illinois and Ohio. We also market ethanol to a large number of independent refiners and independent nonbranded gasoline retailers throughout the United States. We have been involved in ethanol marketing and gasoline marketing since 1981.

It is important to note that the Caribbean Basin exclusion provisions of H.R. 1567 and H.R. 1720 are directed solely at Tropicana because we are the only company which has constructed and is operating an azeotropic distillation refinery in the Caribbean. If these bills pass, our plant will be forced to shut down.

Tropicana International built its plant last year in Kingston, Jamaica. We built it for a variety of reasons; primarily, however, because during the previous years we had experienced severe and repeated ethanol supply disruptions from both our U.S. domestic sources as well as a cutoff of supplies from foreign importers.

Our primary supplier in the United States has been the Archer Daniels Mid-Land Company. On not less than three separate occasions during 1983 and 1984, we were completely deprived of any ethanol supplies for some of our major marketing areas, including California, Texas, and Florida. Further, as we expanded our market territory in response to the demands of our customers for ethanol in other states, we were denied access to supplies by domestic producers in states such as Ohio, Illinois, and Minnesota.

Chairman GIBBONS. Are you saying they, for market reasons, cut you off?

Mr. VIND. Mr. Chairman, we were on no less than three separate occasions during 1983 and 1984 completely cut off of supplies from domestic producers in California, Texas, and Florida. We have been denied access to supplies by the major producers in States such as Minnesota, as well as others.

Chairman GIBBONS. Did you ever try a triple damage suit against them or anything like that?

Mr. VIND. That has been contemplated.

Chairman GIBBONS. Sounds like you have got a good case if your facts are correct.

Mr. VIND. The facts are correct, sir.

In addition, we recognized early on that most States would be severely reducing, or eliminating altogether, their State ethanol-gasohol tax incentives because of their own budget crunches. Therefore, out of desperation and as a means to survive, we had to look to other areas for reliable, continuing sources of ethanol to supply our domestic gasohol blending plants as well as to supply our customers.

The Caribbean Basin Economic Recovery Act [CBERA], or CBI, which became effective January 1, 1984, seemed to offer to us the best of all possible solutions to the problems of acquiring adequate supplies at prices which would not require State tax subsidies. Before we made any commitments, however, we requested a letter ruling from the U.S. Customs Service. In our request, we made a full and complete, detailed disclosure of our project and process—even to the extent of disclosing the source of our feedstocks. The letter ruling issued by Customs to us confirmed that our plant would, in every respect, meet and conform to the legal requirements of the CBERA. In absolute reliance on this letter ruling and following national law as laid down by this Congress, and in full conformance with the Caribbean Basin Initiative, we then proceed to borrow the necessary funds and invest our hard-earned capital in the ethanol azeotropic dehydration refinery in Kingston, Jamaica.

To set the record straight, let me say we have invested over $7 million in cash in the hard assets of this operation, including the plant, as well as the storage facilities and we have had to commit for additional $16 million in binding contracts for feedstocks. The domestic producers would have you believe that you can operate a plant without feedstocks. We had to make commitments for adequate supplies to supply our plant. The total commitment in capital and in feedstocks for our facility exceeds $23 million.

But most importantly, we are currently infusing directly into the Jamaican economy over $1 million per month as direct costs to operate our refinery. We employ—I had originally in my notes 67. My manager from Jamaica is here today and he has updated me. We currently have on our staff 76 full-time employees directly involved in the operation of our plant.

Again, the domestic industry would have you believe that you simply throw a tower in the air someplace and it operates by itself.

There is a complete infrastructure that must be set up and maintained in order to operate a plant of this complexity. We are, for example, required under Jamaican law—and let's not forget that Jamaica qualifies as a Third World nation, this is not the same as building a distillery in the State of Indiana or in the State of Illinois. We must maintain by Jamaican law a 23-man security force armed with submachine guns to prevent potential guerrilla attacks against our employees and intrusions into our plant area.

We buy all of our utilities, the raw materials and denaturant and raw supplies from local Jamaican venders. Our plant is equivalent to hiring 1,000 textile workers in Jamaica because we are paying over ten times the average weekly Jamaican salary because of the quality and caliber of employees required to operate this facility.

In addition, we have contracted with many other Caribbean nations to acquire their local alcohol feedstocks. Tropicana's plant is the largest single investment to date under the CBI. Our contractual commitments during 1986 require us to process over $5 million of local Caribbean feedstocks in our Jamaican plant. Ultimately, our goal is to source 100 percent of the feedstocks for our plant from neighboring Caribbean nations. Tropicana has not, nor will it ever, process Brazilian feedstocks in its plant.

Our startup feedstocks came from surplus Spanish wine stocks. We were encouraged to purchase from the country of Spain, because the Commerce Department has conducted numerous seminars, one conducted over 2 years ago at the city of Madrid, encouraging the three-way trade between the European Community, the Caribbean nations, and the United States. We have fulfilled that in every way. For the record, we absolutely refute allegations by U.S. producers that we have taken Brazilian 200-proof alcohol and added water and taken the water out in Jamaica. It is simply not true.

Before we produced our first gallon of fuel grade ethanol for import into the United States, the domestic industry led by ADM, the corporate giant which produces now almost 70 percent of all the ethanol produced in the United States, and the National Corn Growers Association challenged our letter ruling. This challenge was done under Customs regulations in the form of a 516 petition. It was reviewed and commented on by literally every interested party in the United States and Caribbean ethanol industry.

At the conclusion of many months of this exhaustive process, and after the review of thousands of pages of testimony, the Customs Service on November 19, 1985, upheld its prior ruling and advised the petitioners that the process which Tropicana employed in its Jamaican facility did, without a doubt, constitute a "substantial transformation" into a "new and different article of commerce," thereby completely complying with the requirements of the CBERA.

I am not an engineer, but the documents I presented to you will go into that extensively. It is very, very difficult to remove water that has been combined with alcohol in an azeotrope. The problem you have is that you can go through a normal, simple distillation process, a backyard still, for example. You can take fermented mash and then you can distill this material through a copper still and distill it all day long and you cannot exceed a material that is more than 95 percent pure, greater than that.

In order to remove that last 5 percent water, which you must do in order to use that material as a component of gasohol, you have to break the azeotrope. An azeotrope is where two compounds have a similar boiling point and you can no longer break those apart. Therefore, you must go through the azeotropic distillation process. Our facility in Jamaica utilizes an azeotropic column over 158 feet high, almost 8 feet in diameter and the pictures I presented to the committee will photographically illustrate this is by far not a simple process. This is a very complex process requiring a high degree of skill and high degree of capital investment, and it is not simply a matter—it is not the same as taking and putting water in. You cannot do that. It would be like trying to take and put an egg back into its shell. The similarities simply are not there.

What also seems to have been overlooked in all these attacks upon our operation is the fact Tropicana must, in order to maintain its duty-free status, add a value of 35 percent within the country of Jamaica. We have just concluded an exhaustive audit by the U.S. Customs Service which we requested. It was at our request, because we wanted to set the record straight. It has conclusively demonstrated that we have, even during the initial 5-month startup period, met the 35-percent requirement, and we are now greatly exceeding this 35-percent requirement.

After all, isn't this the original and underlying reason for the CBERA in the first place? Was not the CEBRA passed in order to invite and encourage investment by the U.S. private sector in the Caribbean? Did it also not provide adequate safeguards by requiring the three tests be met? No. 1, substantial transformation into a new or different article of commerce, and added value of not less than 35 percent?

We have done all those things. I might also point out again and remind the committee that ethanol was considered when the CBI was first considered, and ethanol was rejected as something that should be eliminated from the CBI along with textiles and some other components.

In addition, I must point out that we have not, notwithstanding what the other testimony was this morning regarding the Panamanian and El Salvadorian response, we have created a demand and a new market for Caribbean agriculture because neither our plant nor any other plant can operate without utilizing a substantial portion of its feedstocks from CBI nations we are currently inducing into our feedstocks. Over 30 percent of our total cost of production is Caribbean Basin nation hydrous ethanol feedstocks.

Again, for those who would attempt to portray our azeotropic distillation refinery as a simple plant that performs a simple dewatering process, I presented the documentation and pictures to you.

The domestic industry has made unsubstantiated claims that Tropicana's plant has, or will, cause severe and irreparable economic harm and damage to U.S. producers. The allegations are completely false. Let's put Tropicana's plant into true perspective: At the rate of 20 million gallons per year, our plant could supply less than 2.5 percent of the current demand for fuel ethanol in the United States. Demand this year will exceed 800 million gallons and is rising. The domestic industry, according to a letter that was just issued last week by the Renewable Fuel Association, over Mr. Vaughn's signature, stated the American industry can only produce 600 million gallons per year. Last year, there was a shortfall between demand and production of 150 million gallons. This was made up primarily by Brazilian imports. The domestic producers, however, were successful in knocking out these Brazilian imports by their countervailing duty and dumping suits.

The question now is where will ethanol come from to replace these Brazilian imports? Will Tropicana and its customer's once again suffer a cutoff of this clean-burning, high-octane lead replacement?

Regarding Panama and El Salvador, we have just concluded a purchase agreement and have purchased all of the El Salvadorian hydrous ethanol feedstocks, and we are currently processing those in our Jamaican plant. The countries of Costa Rica and Jamaica have also been major suppliers of CBI feedstocks for our plant. I think it is noteworthy that the country of Jamaica, through its Petro-Jam facility, the state-owned refinery, as well as its state-owned sugar operation, have also announced plans to install ethanol refineries within their country, and they will be utilizing non-Caribbean feedstocks because, Mr. Chairman, there simply are not enough Caribbean feedstocks available to source for a plant of not only our size, but certainly not for the size of a plant the size that is going to be operated by the Jamaican Government.

Chairman **Gibbons**. I am a little confused, and I don't want to interrupt this thing too long. You say there is no Brazilian alcohol going through your plant?

Mr. **Vind**. Absolutely not so.

Chairman **Gibbons**. You just use a little Spanish wine, alcohol. Then what is the big argument about all the rest of the stuff is coming from the Caribbean?

Mr. **Vind**. Frankly, I am at a loss to understand why there is an argument. I think the——

Chairman **Gibbons**. Excuse me. Pardon me, I am trying to think this through. You wouldn't even need a special ruling if most of the stuff you are going to run through your plant came out of the Caribbean. It is only for the material that comes from outside the Caribbean that you would need any special ruling from Customs.

Mr. **Vind**. We requested, in advance—to be certain we were complying with the law—we requested of Customs for them to tell us whether or not our plant would comply with the requirements of the CBI.

Chairman **Gibbons**. Because if what you are working on in that plant is a product of the Caribbean, then you don't need any special ruling. If what you are running through that plant comes from outside the Caribbean, then you probably would need a special ruling to make sure what you were doing was going to be a substantial transformation.

Now, if you just use a little Spanish wine—is that supply gone?

Mr. **Vind**. We have only feedstocks to last through 1986 contracted for. We have no prospective other supplies. We are attempting to encourage these nations in the Caribbean to give us their feedstocks. One of the reasons, Mr. Chairman, we located our plant in

Jamaica is that within the Caribbean—Jamaica is centrally located. And that is the reason we put up what we call our magnet plant there with the ultimate goal of sourcing 100 percent of all of our feedstocks for this plant from the Caribbean nations.

But the irony is this; the Caribbean nations have taken so much sugarcane lands out of production that there are not enough feedstocks available. So we had to put the cart before the horse, so to speak, and now we are beginning to see once again production of hydrous ethanol feedstocks for our plant.

We think, and I have presented testimony to individual members of this committee, as well as within my testimony, we feel that within a few years we can totally source all of the feedstocks for this plant from Caribbean nations. I also want to state——

Chairman GIBBONS. Where are your feedstocks coming from now?

Mr. VIND. Our feedstocks are coming from Spain, Costa Rica, El Salvador, Panama, Jamaica, and we hope from Guatemala.

Mr. FRENZEL. What percent from Spain?

Mr. VIND. The percent from Spain right now is 70 percent. Initially we started with 100 percent. We have moved up to 30-percent CBI feedstocks, and we project, again, within a few years it will be 100 percent.

Chairman GIBBONS. Is the Spanish feedstock wine, alcohol, or——

Mr. VIND. It is produced from grapes, Mr. Chairman.

Chairman GIBBONS. And it is only those grapes that make—you have to have any kind of special ruling from Customs?

Mr. VIND. Unless the product is wholly a manufacture of the Caribbean nation, it must undergo their test, transformation, and the 35-percent value added. Even if it is only 1 percent of that, it would have to be, unless it is wholly the growth and manufacture. That is the reason we asked for the ruling.

Chairman GIBBONS. Excuse me for interrupting.

Mr. VIND. We are not against all of the provisions of the Leach and Durbin bills or the bill proposed by Congressman Michel. In fact, we do support many of the items contained. The issues which we feel are true loopholes are those that allow for the mixture offshore of ethanol with certain chemicals, thereby allowing these mixtures to slip in under the guise of the chemical compound classification as opposed to being classified as fuel ethanol with its much higher tariff. These loopholes rightly should be closed.

We do object, however, very strenuously to CBI fuel ethanol production being grouped together with these obvious loopholes. If I could make a recommendation and close my testimony, we do support the proposals by Congressman Leach, Michel, and Durbin and also Senator Dole to close the loophole on mixtures of ethanol with other chemicals. We object to the provisions of both bills H.R. 1567 and H.R. 1720, which would remove the duty-free status from ethanol which is produced in Tropicana's refinery in Jamaica.

This refinery was built and is being operated in good faith with absolute reliance upon existing law as the largest single investment yet to be made under the CBI. To remove the duty-free status from the production of this plant would be tantamount to closing it down, and would not only destroy the economic viability of my company but would also destroy the credibility of the Congress and the administration in that it would demonstrate to the Caribbean nations that the CBI is really just a sham and that any domestic interest could, provided they have access to the Congress, remove the duty-free status from any product at any time.

As Prime Minister Edward Seaga said at the dedication of our plant in Kingston, Jamaica, on March 9, 1985: "The U.S. Congress can be accused of sending mixed and confusing signals to Caribbean nations." And I would hope the Congress can get the record straight and recognize that those companies and those countries that have followed the letter of the law of the CBI, that they should be allowed to maintain and protect their investments in the Caribbean nations.

One final thing, Mr. Chairman, the provisions relating to Caribbean ethanol in these bills simply are not needed. Why? The CBI already contains provisions for redress and relief by domestic interests if they can demonstrate that they are being harmed by importations from the Caribbean. These safeguards were included in the original law. The fact that the domestic interests were successful in their battle against heavily subsizied Brazilian ethanol imports should give them the solace that they have the ability to seek quick and speedy relief under already existing law.

I submit to you that these laws are prospective in nature only. I urge this committee to delete the provisions of these bills that would exclude duty-free importation, but I also urge adoption of those provisions which would close the loophole on mixtures of ethanol and various chemicals.

Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

STATEMENT OF RICHARD B. VIND, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF TROPICANA ENERGY CO., INC.

Introduction: My name is Richard B. Vind, I am President and Chief Executive Officer of Tropicana Energy Co., Inc. and its affiliate, Tropicana International [Jamaica] Ltd. We are a small privately held ethanol and gasohol distribution marketing company which owns and operates gasohol blending terminals in Fort Worth, Texas, Illinois and Ohio. We also market ethanol to a large number of independent refiners and independent non-branded gasoline retailers throughout the United States. We have been involved in ethanol marketing and gasoline blending since 1981. It is important to note that the Caribbean Basin exclusion provisions of H.R. 1567 and H.R. 1720 are directed solely at Tropicana because we are the only company which has constructed and is operating an azeotropic distillation refinery in the Caribbean. If these bills pass, our plant will be forced to shut down.

Tropicana International built its plant last year in Kingston, Jamaica. We built it for a variety of reasons; primarily, however, because during the previous years we had experienced severe and repeated ethanol supply disruptions from both our U.S. domestic sources as well as a cut off of supplies from foreign importers. On not less than three separate occasions during 1983 and 1984, we were completely deprived of any ethanol supplies for some of our major marketing areas, including California, Texas and Florida. Further, as we expanded our market territory in response to the demands of our customers for ethanol in other States, we were denied access to supplies by domestic producers in States such as Ohio, Illinois and Minnesota. In addition, we recognized early on that most States would be severely reducing, or eliminating altogether, their State ethanol-gasohol tax incentives because of their own budget crunches. Therefore, out of desperation and as a means to survive, we had to look to other areas for reliable, continuing sources of ethanol to supply our domestic gasohol blending plants as well as to supply our customers.

The Caribbean Basin Economic Recovery Act [CBERA], or "CBI", which became effective January 1, 1984, seemed to offer to us the best of all possible solutions to the problems of acquiring adequate supplies at prices which would not require State tax subsidies. Before we made any commitments, however, we requested a Letter Ruling from the U.S. Customs Service. In our request, we made a full and complete, detailed disclosure of our project and process - even to the extent of disclosing the source of our feedstocks. The Letter Ruling issued by Customs to us confirmed that our plant would, in every respect, meet and conform to the legal requirements of the CBERA. In absolute reliance on this Letter Ruling and in full conformance with the Caribbean Basin

Initiative, we then proceeded to borrow the necessary funds and invest our hard earned capital in an ethanol azeotropic dehydration refinery in Kingston, Jamaica. We spent over $7,000,000 cash for plant and storage facilities; an additional $16,000,000 for feedstocks; and most importantly, we are currently infusing into the Jamaican economy over $1,000,000 per month as direct costs to operate our refinery. Tropicana employs 67 full time Jamaican employees and buys all of its fuel oil, utilities, denaturant, raw materials and operating supplies from local Jamaican vendors. In addition, we have contracted with many other Caribbean nations to acquire their local alcohol feedstocks. Tropicana's plant is the largest single investment to date under the CBI. Our contractual commitments during 1986 require us to process over $5,000,000 of local Caribbean feedstocks in our Jamaican plant. Ultimately, our goal is to source 100% of the feedstocks for our plant from neighboring Caribbean nations. Tropicana has not, nor will it ever, process Brazilian feedstocks in its plant. Our start-up feedstocks come from surplus Spanish wine stocks. For the record, we absolutely refute allegations by U.S. producers that we have taken Brazilian 200 proof, added water, and then taken the water out in Jamaica.

Before we produced our first gallon of fuel grade ethanol for import into the United States, the domestic industry, lead by Archer-Daniels Midland Co. [ADM], the corporate giant which produces almost 70% of all the ethanol produced in the U.S., and the National Corn Growers Association, among others, challenged our Customs' Letter Ruling. This challenge, which was done under Customs Regulations in the form of a "516 Petition", was reviewed and commented-on by literally every interested party in the United States and Caribbean ethanol industry. At the conclusion of many months of this exhaustive process, and after the review of thousands of pages of testimony, the Customs Service on November 19, 1985, upheld its prior ruling and advised the Petitioners that the process which Tropicana employed in its Jamaican facility did, without a doubt, constitute a "substantial transformation" into a "new and different article of commerce"; thereby, completely complying with the requirements of the CBERA.

What seems to have been overlooked in all of these attacks upon Tropicana's operation, is the fact that Tropicana must, in order to maintain its duty-free status, also add a value of 35% within the country of Jamaica. Tropicana has conclusively demonstrated to Customs (which has just concluded an extensive audit of Tropicana's books and records at Tropicana's insistence) that it has, in fact, met with and will continue to meet the 35% value added requirement. After all, isn't this the original and underlying reason for the CBERA in the first place? Was not the CBERA passed in order to invite and encourage investment by the U.S. private sector in the Caribbean? Did not the CBERA provide adequate safeguards against "mere pass through operations" by its difficult requirements to meet the "substantial transformation" and "35% value-added" requirements? For those who would attempt to portray our azeotropic distillation refinery as a "simple process" which "performs a simple de-watering process"; or would have you believe that taking water out is the same as putting water in, I would like to give to this Committee pictures of our Jamaican Plant. The primary distillation column is 158 feet high, 8 feet in diameter; the generators which power this plant could light a small city. Why then, are these bills being proposed - which if passed, would shatter and destroy the very fabric of the CBERA? As Prime Minister Edward Seaga said at the dedication of Tropicana's plant in Kingston, Jamaica on March 9, 1985, ..."The U.S. Congress can be accused of sending mixed and confusing signals to the Caribbean nations."

The domestic industry has made unsubstantiated claims that Tropicana's plant has, or will, cause severe and irreparable economic harm and damage to U.S. producers. The allegations are completely false. Let's put Tropicana's plant into true perspective: At the rate of 20,000,000 gallons per year, our plant could supply less than 2.5% of the current demand for fuel ethanol in the United States. Demand this year will exceed 800,000,000 gallons and is rising. The domestic industry can only produce 600,000,000 gallons per year. Last year there was a shortfall of over 150,000,000 gallons which was made up by Brazilian imports. The domestic producers, however, were successful in knocking out these Brazilian imports when they filed their successful anti-dumping and countervailing duty suits. The question now is; Where will the ethanol come from to replace these Brazilian imports? Will Tropicana and its customers, once again, suffer a cut-off of this clean-burning, high octane lead replacement?

Tropicana is not against all of the issues contained in the Leach and Durbin Bills. In fact, Tropicana understands that Congressman Michel just last week introduced a bill which would also deal with the real issues at stake here. These issues are how to close the true loopholes in existing Customs law that allow for the mixture, offshore, of ethanol with certain chemicals, thereby allowing these mixtures to slip in under the guise of a chemical compound classification as opposed to being classified as fuel ethanol with its much higher tariff. These loopholes rightly should be closed. Tropicana, however, strenuously objects to CBI fuel ethanol production being grouped together with these obvious loopholes.

Conclusion and Recommendation: Tropicana supports the proposals by Congressmen Leach, Durbin and Michel (and also of Senator Dole) to close the loopholes on mixtures of ethanol with other chemicals. Tropicana, however, objects to the provisions of H.R. 1567 and H.R. 1720 which would remove the duty-free status from ethanol which is produced in Tropicana's refinery in Jamaica. This refinery was built and is being operated in good faith with absolute reliance upon existing law and is the largest single investment yet to be made under the CBERA. To remove the duty-free status from the production of this plant would be tantamount to closing it down and would not only destroy the economic viability of Tropicana, but it would also destroy the credibility of the Congress and the Administration in that it would demonstrate to the Caribbean nations that the CBI is really just a sham and that any domestic interest can, provided they have access to the Congress, remove the duty-free status from any product, at any time. If the CBI is to be successful, it must be maintained intact. To begin to remove, one by one, qualifying products from the CBI, would be the same as destroying it altogether.

Finally, the provisions relating to Caribbean ethanol in these bills simply are not needed. Why? The CBI already contains provisions for redress and relief by domestic interests if they can demonstrate that they are being harmed by importations from the Caribbean. These safeguards were included in the original law. The fact that the domestic interests were successful in their battle against heavily subsidized Brazilian ethanol imports, should make it apparent that, if they are damaged, they have the ability to seek quick and speedy relief under already existing law.

I urge this Committee to delete the provisions in these bills that would exclude duty-free importation for ethanol produced from an azeotropic distillation facility; but I also urge adoption of those provisions which would close the loopholes on mixtures of ethanol and various chemicals.

Please direct any questions or comments to Mr. Richard B. Vind, P.O. Box 1400, 3000 Birch Street, Brea, California; telephone (714) 992-0925.

TROPICANA INTERNATIONAL (JAMAICA) LTD.

Tropicana International [Jamaica] Ltd., is presenting for the record the following information regarding Tropicana's azeotropic distillation ethanol refinery in Kingston, Jamaica. There has been a great deal of misinformation or deliberate disinformation spread about Tropicana's facility and its operations and we appreciate this opportunity to set the record straight.

There has been a tremendous amount of interest generated about this plant, much of it fostered by the desire of one major midwestern ethanol manufacturer and its related farm groups to eliminate Tropicana's plant from competing in the United States market. It is unfortunate that these groups feel it necessary to spread false information about Tropicana in order to achieve their objectives.

In the spirit of fairness, I hope that the Committee will not be swayed by these obviously slanted distortions; but, rather that it will assess the facts and determinations according to its best judgment of these facts.

The following is a summary of who we are, what we do, and how we got there:

1. Tropicana conceived this major investment as a result of its continued inability to obtain sufficient supplies of ethanol from U.S. domestic sources. Tropicana is the largest independent consumer and reseller of fuel grade ethanol in the United States. Tropicana operates in seventeen states from California through Texas and Florida and into the midwest as far north as Minnesota. Tropicana owns and operates a small gasoline refinery in Fort Worth, Texas and two large gasoline blending terminals in Chicago, Illinois and Cleveland, Ohio. All of Tropicana's facilities utilize ethanol as an octane booster and lead replacement in the gasolines that it manufactures and sells to its customers. Since 1981, Tropicana has experienced severe supply disruptions and actual cut-offs in supplies of ethanol on three separate occasions. Tropicana therefore felt compelled to become a manufacturer of ethanol in order to protect and preserve its U.S. investments.

2. Tropicana's Jamaican Plant. Prior to investing in its plant in Kingston, Jamaica, Tropicana sought and received a private letter ruling from the United States Customs Service. In its submittal to Customs, Tropicana completely and concisely set forth all details of its proposed

operation under the CBERA (more commonly known as the Caribbean Basin Initiative - "CBI"). Tropicana received an opinion letter from Customs affirming that Tropicana's proposed Jamaican plant would in fact qualify the products from that plant for duty-free entry into the United States under the CBI. In absolute reliance upon this ruling, which was made after a full and complete disclosure of the process and feedstocks to be used, Tropicana commenced with the construction of its ethanol refinery.

3. Before Tropicana produced its first gallon of fuel grade ethanol from its Jamaican plant, the U.S. industry, lead by industry giant Archer-Daniels Midland Company (ADM), Decatur, Illinois, and the National Corn Growers Association, among others, petitioned the U.S. Customs Service demanding that the Customs Service immediately revoke Tropicana's private letter ruling alleging, among other things, that Tropicana would cause irreparable harm and damage to the U.S. industry and that Tropicana would "commit a whole host of devious practices" including taking Brazilian 200 proof ethanol, watering it down and transshipping it through its plant. (ADM produces well over 50 percent of U.S. fuel ethanol, and just announced an increase in production to 500,000,000 gallons per year. This will represent over 70 percent of U.S. production. Tropicana's plant can produce not more than 2 percent of projected U.S. demand for 1985.) Tropicana assisted the U.S. Customs Service in defending its ruling regarding the substantial transformation process employed in its Jamaican refinery against these attacks by the domestic industry. (Tropicana's legal and related fees to defend its plant have already exceeded $400,000.) This ruling was upheld by the U.S. Customs Service on November 19, 1985. The overwhelming preponderance of evidence submitted to Customs verified and upheld that Tropicana's refinery was in fact a "substantial manufacturing operation" that created a "new and different article of commerce". I think it is very important to note that the author of one of the bills before Congress, Congressman Dick Durbin of Decatur, Illinois, admitted to Tropicana that he was convinced that Tropicana was not in fact violating any law, but that he (Durbin) wanted to change the law.

4. Our plant was located in Jamaica for a number of reasons. Among these were the favorable business climate offered by the Seaga Administration, the fact that Seaga was the original proponent of the CBI, and the fact that Jamaica is

centrally located to service the entire Caribbean Basin area. Our plant was designed to be a magnet plant for the entire CBI in the hopes that all of the existing small distilleries in the region would be able to use their surplus beverage grade alcohols and surplus plant capacities and bring those feedstocks to Jamaica where we could transform them into fuel grade ethanol for use in "gasohol" in the United States. We quickly found out, however, that sourcing feedstocks from the CBI was not nearly as simple as we had thought. Many Caribbean nations had drastically reduced their sugar cane acreage thereby eliminating cane for fuel use. (For example, as ironic as it might seem, Jamaica is a net importer of sugar. They import sugar from other nations in order to have enough sugar to meet their U.S. and EEC quotas. Jamaica has reduced its sugar cane acreage by over 50% in the last five years.) Not only did this present a problem, but we also soon found out that we were competing head-on with Caribbean rum distillers for the existing sugar cane production. Further, we encountered an enormous bureaucracy in every country which has thwarted and postponed and denied our proposals in virtually every case. For example, in Jamaica, we have been negotiating with the Seaga Administration since September of 1984 and they still have not made a decision on our proposal to acquire 15,000 acres of sugar cane, lease an existing government-owned sugar mill and build and operate a fermentation-distillation plant near Kingston. (A representative of sugar producers from the Dominican Republic recently at the Caribbean-Central American Conference in Miami, denounced Caribbean ethanol production, citing among other reasons, the vacillating taking place in Congress, and other factors including EPA's proposal to impose severe volatility restrictions on gasohol.) It became quite evident that Tropicana would have a plant with no feedstocks. Therefore, in order to bridge this enormous gap between Tropicana's feedstock requirements and its ability to secure CBI feedstocks, Tropicana entered into contracts for its initial feedstocks from the country of Spain. (Tropicana has not, nor does it ever plan, to process Brazilian ethanol in its facility.) We were encouraged to utilize Spanish feedstocks because of the three-way trade being promoted by the U.S. Department of Commerce as a way to tie together the EEC, the CBI and the United States markets.

5. Tropicana has subsequently had some preliminary (albeit small) successes in obtaining and processing CBI feedstocks. Tropicana will continue to exert every effort including

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making major investments in capital in order to source all of its feedstocks from CBI countries. (Please read the enclosed Exhibit A which outlines the current status of Tropicana's proposals and projects to source CBI feedstocks.) Tropicana's major encouragement so far has been with the countries of Costa Rica, Guatemala, El Salvador and Belize. We are also negotiating with Haiti. Our current capital budget requirements will exceed $3,000,000 in expenditures by April of this year. (This, in order to acquire less than 10% of our plant's feedstock requirements.) In order to totally source our plant from CBI countries, it will require an expenditure of not less than $15,000,000 and at least four years' duration of time.

6. Tropicana's plant operation is in every respect a substantial manufacturing operation and we are a major contributor to the economy of Jamaica. During its first eight (8) full months of operations, Tropicana infused $7,552,000 directly into the Jamaican economy - it is currently spending over $1,000,000 per month to operate its plant and in January, purchased over $700,000 of local Caribbean feedstocks. Tropicana's payroll to operate its plant is $171,618 per month, or over $2,000,000.00 per year.

7. The construction of Tropicana's facility has required a cash outlay of over $5.0 million, and contractual and financial obligations cf an additional $2,700,000 for facility rental and other contract commitments including feedstocks of $16,300,000. (This represents "take or pay" feedstock contract commitments.) Tropicana employed over 320 Jamaican workers in the construction of its plant. It has a full time payroll of 67 Jamaican workers, many of whom have been trained and upgraded into high level positions of plant technical supervision and management. Tropicana has only four non-Jamaican employees directly associated with the plant operation. Tropicana utilizes Jamaican contractors for plant maintenance and repair and tries to purchase all possible supplies and equipment from Jamaican contractors.

We appreciate this opportunity to present this information to you. It is somewhat painful to have to present what is obviously very confidential business information into the public record simply as a means of defending ourselves. But we cannot allow the spreading of lies and misinformation about our operation to threaten our very business existence. We are not a large company. We are independently owned, privately held. We have in fact extended ourselves to the limits of our financial capabilities to build and operate this facility. We built our plant in good faith, in absolute reliance on the U.S. Customs Service ruling, in complete conformity with the CBI and with the total cooperation and assistance of the Jamaican government.

We will use every resource and exhaust every available legal remedy at our disposal in order to stay in business. If our plant is closed, it will have an immense, devastating impact on the entire CBI Program. As Prime Minister Seaga said at our plant dedication in March of last year, "The U.S. Congress can be accused of sending mixed and confusing signals to CBI countries". I hope that I can count on you, your staff and the Committee members to remove these confusing signals. Thank you for your cooperation.

The above testimony has been presented on behalf of Tropicana International [Jamaica] Ltd. and its affiliated company, Tropicana Energy Co., Inc. of Texas. It has been submitted by Richard B. Vind, President and Chief Executive Officer, of 3000 Birch Street, Brea, California 92622, telephone (714) 992-0925.

EXHIBIT "A"

JAMAICAN MOTOR FUEL GRADE ETHANOL PRODUCTION UTILIZING CARIBBEAN BASIN FEEDSTOCKS

The production of motor fuel grade ethanol requires a number of different processing operations. The primary operating stages are:

- Farming of agricultural feedstocks
- Fermentation
- Primary distillation
- Azeotropic (secondary) distillation

Motor fuel grade ethanol must be virtually water free, that is of a proof of not less than 199 (99.5% pure ethyl alcohol). Normal beverage grade alcohols cannot be used as constituents of "gasohol" because the high water content will cause layering or phase separation when mixed with gasoline. The extraction of the final 5% water content of beverage alcohols is performed during the dehydration process which is achieved through the use of azeotropic distillation refineries.

Until Tropicana built its 20 million gallons per year azeotropic distillation alcohol dehydration refinery in Kingston, Jamaica, there were no facilities available in the Caribbean to transform beverage alcohols into motor fuel grade ethanol. (The exceptions are three plants built in El Salvador, Costa Rica and Guatemala, but these plants operate only three months each year utilizing sugar cane bagasse as boiler fuels, and do not have spare dehydration capacity available. The capacity of these plants is limited. They are also located inland on the Pacific side and do not lend themselves to efficient or economic processing of Caribbean feedstocks from other Caribbean Basin locations.)

Tropicana commenced operations of its Jamaican facility utilizing as its primary feedstock, wine alcohol produced in Spain. This is because there is not nearly enough Caribbean Basin alcohol feedstocks produced to be able to support a plant of the size of Tropicana's facility. Now that the Tropicana plant has successfully demonstrated its abilities to produce motor fuel ethanol of excellent quality with virtually no water content, Tropicana is pushing forward with the next phase of its Caribbean Basin Plan - the construction of fermentation-primary distillation facilities in Jamaica and other Caribbean Basin countries. The attached briefing memorandum outlines Tropicana's basic Phase II Program which will ultimately result in Tropicana's Kingston plant being able to process feedstocks produced exclusively from within the Caribbean Basin.

PHASE II
CARIBBEAN BASIN
ALCOHOL FEEDSTOCK PROGRAM

Tropicana has conducted numerous feasibility studies concerning the production of alcohol feedstocks for its Kingston, Jamaica facility. These studies have resulted in Tropicana arriving at the following conclusions concerning the acquisition of 20,000,000 gallons per year of Caribbean Basin produced alcohol feedstocks:

- The only economically viable alcohol feedstock is sugar cane.
- Sugar cane production in Jamaica is inefficient and economically unattractive.
- Lands previously farmed for sugar cane have been removed from sugar cane production in Jamaica because of the Jamaican Crop Diversification Program.
- Existing sugar cane production averages less than one-half of the tons per acre of efficient cane growers such as Hawaii.
- Sugar cane production is geographically scattered making transportation costs high.
- There are no existing distilleries in Jamaica which can be utilized for alcohol feedstock production in the quantities required.
- Similar conditions exist in the other Caribbean Basin nations surveyed so far. These nations include Antiqua, Barbados, Haiti and the Dominican Republic.

As a result of these conclusions, Tropicana has made the decision to extend its Phase II operations to include the entire spectrum of alcohol production, including the farming of sugar cane and the crushing of sugar cane as well as the fermentation and primary distillation and azeotropic dehydration stages.

Tropicana is currently negotiating with both the government of Jamaica and with private cane growers in the Dominican Republic, for the acquisition of cane acreage sufficient to provide enough cane for 20,000,000 gallons per year of alcohol production. This will require a significant amount of capital investment and time. It will not of course be accomplished all at the same time, but will be phased-in in steps as lands are acquired and production facilities are constructed.

Initially, as the first increment of the Phase II Program, Tropicana has negotiated with the Jamaican government to acquire 13,000 acres of sugar cane in the Innswood area. The cane from these acres will be produced directly by employees working under contract to Tropicana and this cane will be transported to the Bernard Lodge sugar mill for cutting, chopping, grinding and juicing. Tropicana is negotiating with the Jamaican government regarding the Bernard Lodge sugar mill. We will end up with one of two agreements: either to take over the entire facility and operate it; or, contract with this facility (which is a government-owned facility) to have the mill process our sugar cane into cane juice and sugar, for a processing fee. The sugar mill currently employs 400 people. The farming operation of the 13,000 acres of cane fields currently requires 1,288 employees. This would be a major farming and processing operation and would require the infusion by Tropicana of at least $1,000,000 U.S. in order to mechanize the cane production, cane transportation and cane juicing systems. Current cane production costs are in excess of $18.00 per ton. Tropicana feels it can and must cut this cost by at least 30% through proper farming practices and mechanization.

It will also be necessary for Tropicana to construct a fermentation-primary distillation facility in the Bernard Lodge area. This plant would be able to produce "wet" (190 proof) alcohol from the current Innswood acreage. Wet alcohol from Innswood at its current crop production rate would supply 2,000,000 to 3,000,000 gallons per year. Properly farmed, these acres should be able to produce in excess of 4,000,000 gallons of alcohol per year. This alcohol, after fermentation and primary distillation, would then be transported to Tropicana's dehydration refinery to be transformed into motor fuel grade ethanol. The total cost of constructing the fermentation-primary distillation plant at Bernard Lodge would be approximately $5,000,000. Tropicana's total capital costs would therefore be an estimated $6,000,000 to produce a maximum of 4,000,000 gallons per year of 190 proof alcohol. The design, engineering and construction will require approximately eighteen months. The farming schedule would require at least twenty-four months to bring the crop lands into adequate production levels. A crop rotation program has to be implemented in order to provide feedstocks well beyond the normal three to four month harvest cycle. This will insure a more orderly flow of feedstocks to the distilleries. Because of the competition for land on Jamaica, there do not appear to be any other economically viable cane lands within suitable transportation distance of Bernard Lodge. This could change if the Jamaican government modifies its Agro-21 Crop Diversification Program. Because of uncertainties surrounding the possible future availability of suitable cane acreage, Tropicana feels it is necessary to secure the balance of its Caribbean Basin alcohol from outside of Jamaica. The most promising country for this purpose would be the Dominican Republic.

The Dominican Republic has a much larger land area than Jamaica and will lend itself to the construction of an additional fermentation-primary distillation plant. Tropicana is currently conducting a feasibility study regarding this proposed facility which would require not less than 15,000 and up to 30,000 acres of sugar cane in order to provide the feedstocks for a 15,000,000 to 17,000,000 gallons per year alcohol plant. Tropicana's proposal is to either contract with cane growers or, do as it's going to do in Jamaica - take over the cane farming itself in order to secure adequate cane at economic prices.

A 15,000,000 to 17,000,000 gallons per year fermentation-distillation plant would cost not less than $7,000,000 to $10,000,000 U.S. Additional capital might be required if Tropicana has to construct its own sugar milling plant. There are existing sugar mills which could be utilized, but Tropicana cannot make a determination at this date as to the feasibility of doing this.

The time frame for design, engineering and construction of a major plant in the Dominican Republic would not be less than eighteen months, again somewhat depending upon the requirement to construct or not to construct, or modify an existing sugar mill. Again, it will be necessary to significantly expand cane production per acre in order to bring the economics down to a reasonable level. This will require not less than a full twenty-four to thirty-six month period. These estimates are probably very optimistic; in fact, most industry experts feel that full production could not be achieved prior to four years.

SUMMARY

Tropicana's Phase II Program can be summarized as follows:

1. Acquisition of 13,000 acres of sugar cane in Jamaica.
2. Acquisition and modernization of Bernard Lodge sugar mill.
3. Construction of a 4,000,000 gallons per year alcohol plant at Bernard Lodge.
    - o All of the above at a capital cost of $5,000,000.
4. Acquisition of sugar cane acreage in the Dominican Republic.
5. Construction of sugar mill and fermentation-primary distillation plant in the Dominican Republic.

- o Total capital cost - Dominican Republic between: $ 7,000,000 to $10,000,000
- o Grand total capital commitment between: $12,000,000 to $15,000,000
- o Time required to bring both plans into full operation: 36 to 48 months
- o Total employment by Tropicana in growing, milling, distillation, would be in excess of 4,000 employees. Total contribution of the economy of Jamaica would be at least $5,000,000 U.S. per year. In the Dominican Republic, total contribution to the economy would be at least $15,000,000 U.S. per year.

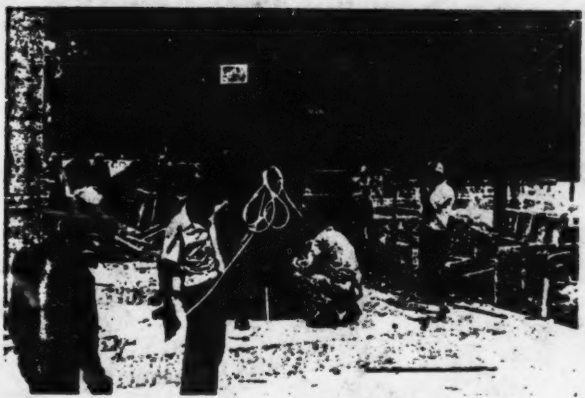
ETHANOL DEHYDRATION FACILITY

KINGSTON, JAMAICA

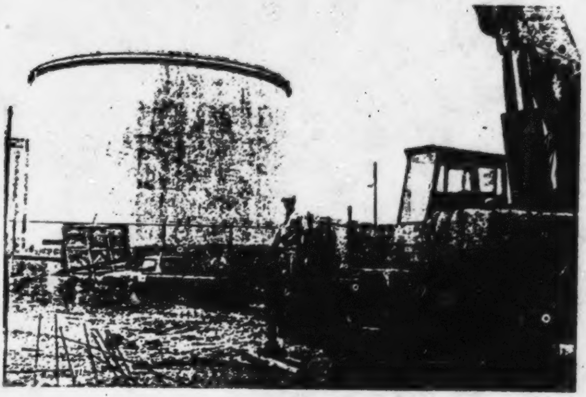
Tropicana

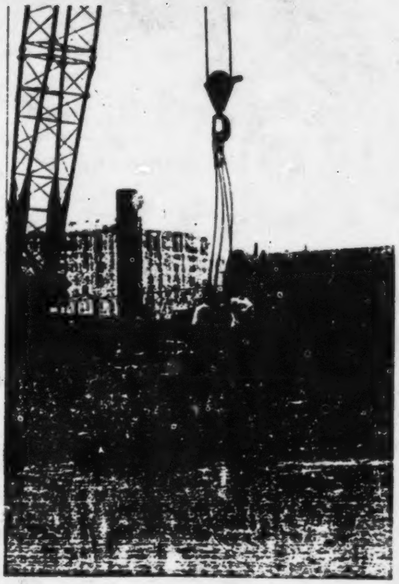
Employment of Jamaican workers

Ethanol Dehydration Facility -
Kingston, Jamaica



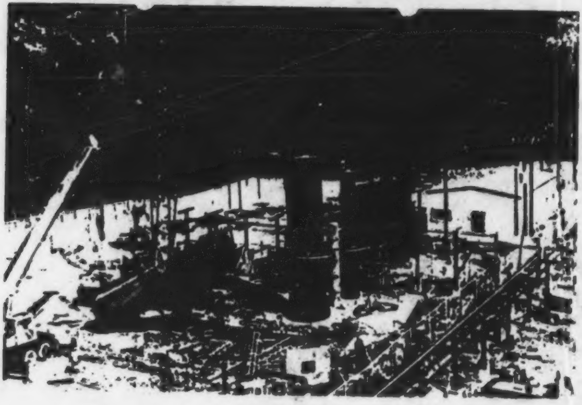
Employment of Jamaican Workers
TROPICANA - KINGSTON, JAMAICA

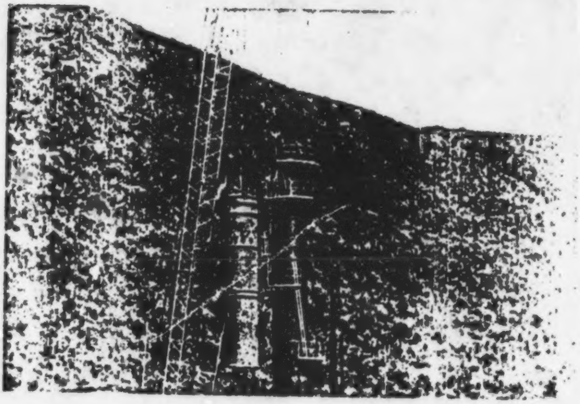




Construction Phase
Ethanol Dehydration Plant
TROPICANA · KINGSTON, JAMAICA

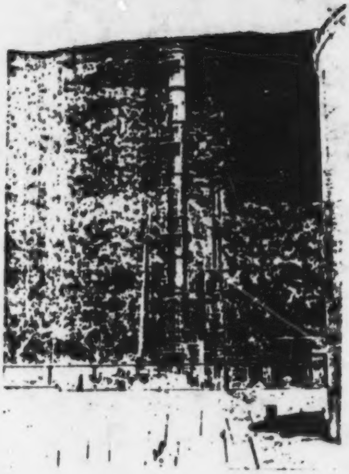
Erection of Ethanol Azeotropic
Dehydration Column
January, 1985
TROPICANA · KINGSTON, JAMAICA

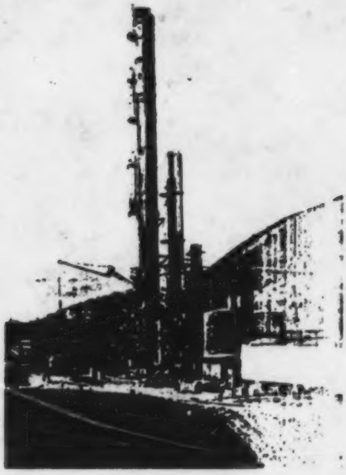




Tropicana

Erection of Ethanol Azeotropic Dehydration Column
Kingston, Jamaica
January, 1985

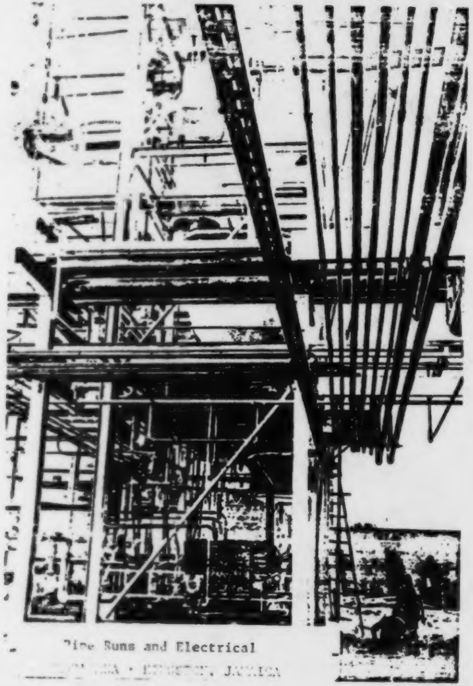




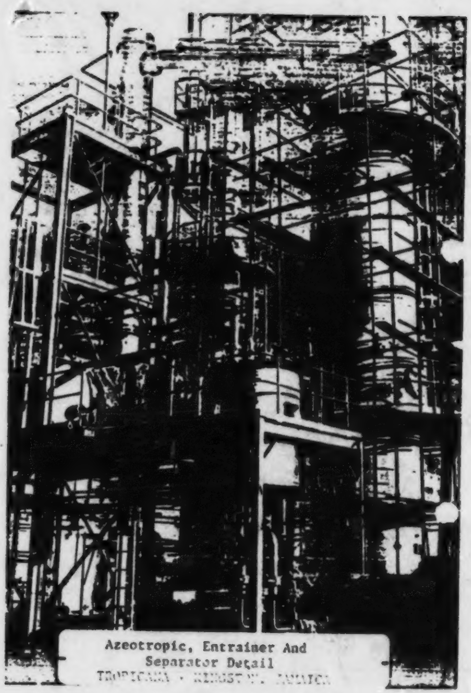
Tropicana

Ethanol Azeotropic Dehydration and Entrainer Columns

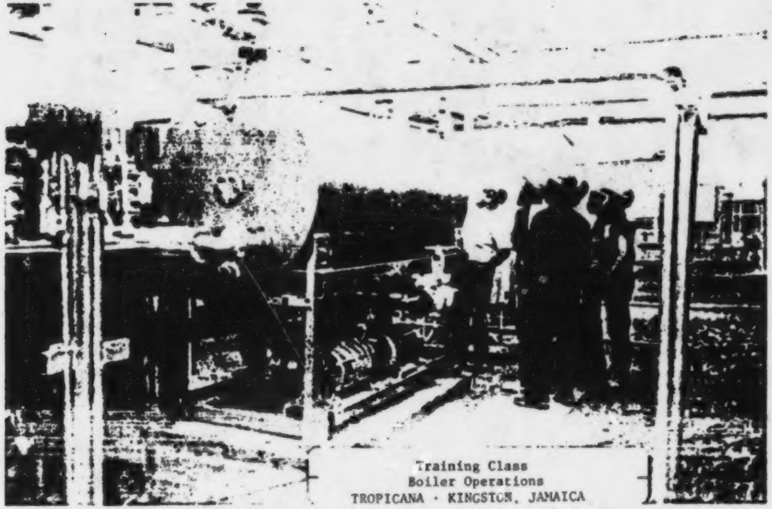
Kingston, Jamaica



Pipe Runs and Electrical
TROPICANA · KINGSTON, JAMAICA

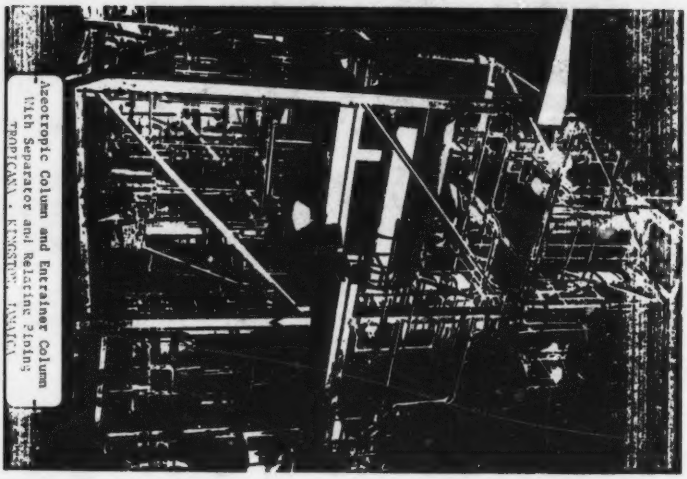


Azeotropic, Entrainer And
Separator Detail
TROPICANA · KINGSTON, JAMAICA

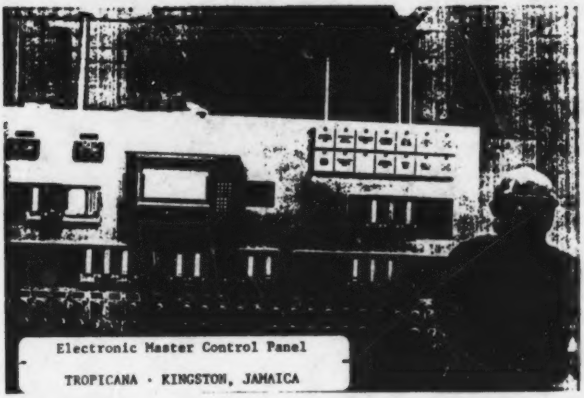


Training Class
Boiler Operations
TROPICANA · KINGSTON, JAMAICA

Quality Control Laboratory
With Gas Chromatographs
TROPICANA · KINGSTON, JAMAICA

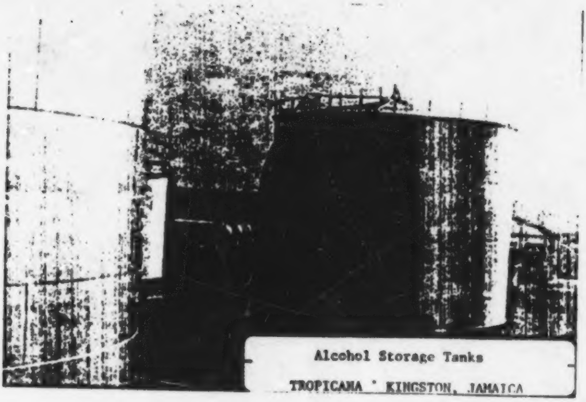


Azeotropic Column and Entrainer Column
With Separator and Relating Piping
TROPICANA · KINGSTON, JAMAICA



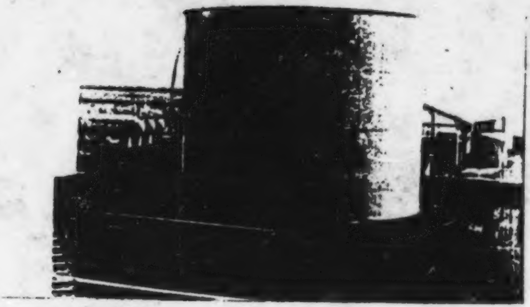
Electronic Master Control Panel

TROPICANA · KINGSTON, JAMAICA



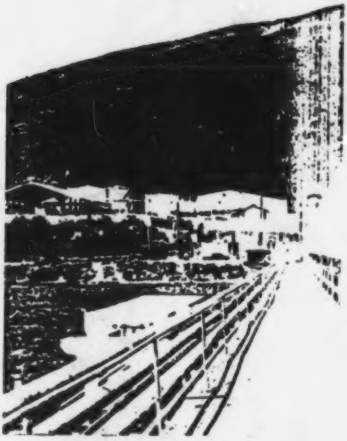
Alcohol Storage Tanks

TROPICANA · KINGSTON, JAMAICA



Tropicana

Ethanol Storage Tanks
Kingston, Jamaica



Tropicana

Marine Jetty and Storage Tanks
Kingston, Jamaica

Chairman **Gibbons**. Let's go ahead with the rest of the witnesses. I apologize to the rest of the witnesses. Let's hear the rest of you. Chemical Fuels Corp.

STATEMENT OF DONALD G. DOIRON, PRESIDENT, CHEMICAL FUELS CORP.

Mr. **Doiron**. I have submitted a written statement for the record. I appreciate this opportunity to tell you something about Chemical Fuels Corp., its future plans and views on the issues presented by the legislation before you.

Alcohol fuels have a tremendous future in this country as a clean, safe, and reliable extender of gasoline and as a replacement for lead as an octane enhancer. The EPA's recently mandated lead phasedown will create a demand potential for new sources of octane.

CFC is a Georgia-based company with alcohol fuel blending facilities in the Southeast. We are in the business of producing, fermenting, and distributing alcohol-blended fuels. We have successfully implemented a pilot program underway in North Carolina in which we are market testing more cost-effective blends of ethanol with methanol under the supervision and with the cooperation of the State highway department.

Our intention is to demonstrate those blends will provide safe, effective, economic octane enhancers for the benefit of American consumers.

We feel we are making progress. Our blending program is an important step toward development of a national market for alcohol fuels and thereby provide a growing and dependable market for producers of both ethanol and methanol.

Programs like ours are critical to the future of the U.S. ethanol industry and the key to the widespread use of alcohol fuels without dependence on Federal and State tax subsidies for their economic viability.

Unfortunately, we are viewed with some suspicion by the domestic ethanol industry. They think we are out to steal their market with imported ethanol, driving them out of the business, of destroying the market for surplus midwestern grain.

We don't deserve that suspicion. Our activities in the Southeast are establishing new markets for domestic industries and others having a long-term interest in the market for alcohol fuels.

The southeastern market is not served by the domestic industry and will not be for some time to come, for one very important reason: It does not provide the network of State tax support which supplements the Federal tax support, the combination of which is necessary for domestic ethanol to compete with other gasoline octane enhancers.

Alcohol fuels offer consumers everywhere an enormous economic and environmental benefit. The consumers and taxpayers of the southeast deserve these benefits as much as the good citizens of the Midwest.

For the past 2 years we have supplied our southeastern distribution network with ethanol imported primarily from Brazil under the authority of existing law and lawfully issued Customs Service rulings.

To supply our network in the future consistently with what we believe to be the understanding and will of Congress, we have undertaken to develop a full-scale ethanol fermentation facility in the U.S. Virgin Islands where we will produce fuel grade alcohol from sugar grown in the Dominican Republic, St. Kitts, and other countries.

Our fermentation facilities will be completed by the end of 1986. The facility will directly provide a significant number of jobs for citizens in the Virgin Islands, where I think you heard yesterday Delegate de Lugo say the unemployment was substantially increased in that country recently because of the major industrial shutdowns that have just occurred.

Our project has the full and enthusiastic support of Governor Luis, Delegate de Lugo, and the local officials in St. Croix. It is the kind of economic development which this committee has sought to encourage through its program of trade incentives for the Caribbean region.

In addition to supplying our markets in the Southeastern United States we will also look to markets in Europe and the Far East for our Virgin Islands ethanol.

Develpment of our facility in the Virgin Islands involves a very substantial investment. Our commitment to making that investment was based on current law and a series of U.S. Customs Service rulings recently reaffirmed providing duty-free treatment of ethanol distilled in the Virgin Islands. In order to maintain the continuity of supply in our market already established in the Southeast we must be able to dehydrate at least during the period between completion of our distillation column and completion of our fermentation facilities.

Our distillation column will be operational May 1986 and the fermentation facility should be operational by the end of 1986. For that reason, we are grateful for the direction expressed in the Tax Reform Act committee report to provide for some reasonable transition in any phaseout of duty-free treatment for product upgraded in the Virgin Islands.

With a reasonable transition rule, we do not oppose phaseout of the duty-free treatment of ethanol which is only dehydrated in beneficiary countries.

We do, however, urge the committee to expressly reaffirm its commitment to duty-free treatment of alcohol which is both fermented and distilled in the Caribbean and the Virgin Islands.

For the future, we urge the committee to reexamine the likely effect of the provision of the Tax Reform Act which calls for repeal of the blender credit. The blender credit is not widely used presently but provides an important key to weaning the ethanol industry from reliance on both State as well as Federal tax subsidies on the schedule established by Congress.

We of course support continuation of the Federal excise tax exemption. But reliance on the excise tax exemption alone would have to have unfortunate consequences for our national policy.

It would require all Federal subsidization of the ethanol industry to come out of the highway trust fund, and it would seriously impede the development of ethanol as a cosolvent with more economical methanol.

I would urge the members of this subcommittee to reconsider what we believe to be an unfortunate decision by the House Ways and Means Committee to eliminate the blender credit.

To conclude, I firmly believe that our interests at Chemical Fuels are complimentary with, rather than opposed to, those of the domestic ethanol industry.

They are clearly consistent with the interests of the American consumer nationwide. More importantly for this subcommittee, the market my company is developing in the Southest represents an important opportunity for our friends in the Virgin Islands and the Caribbean Basin because it represents a dependable market and a new market for a product whose production in those countries will provide substantial economic development in the region.

Mr. Chairman, I appreciate your consideration of our immediate concerns in the transition rule for this legislation.

[The prepared statement follows:]

STATEMENT OF DONALD G. DOIRON, PRESIDENT, CHEMICAL FUELS CORP.

Topical Outline and Summary

CFC's Ethanol Production in the Virgin Islands

CFC is making a substantial investment in the construction of an ethanol fermentation and distillation facility in St. Croix, V.I. The distillation capability will be in place by April 1, 1986, and the complete facility is expected to be operational by December 31, 1986.

The feasibility of the project depends in part upon CFC's ability to utilize its distillation apparatus pending completion of the fermentation facilities to maintain continuity of supply for its markets in the Southeastern United States. CFC's commitment to the Virgin Islands was based on existing law and Customs Service rulings which allow duty free importation under TSUS General Headnote 3(a) of fuel grade alcohol produced in the Virgin Islands by distillation of 190 proof ethanol fermented elsewhere. Therefore, CFC opposes any abrupt change in existing law, and urges the committee to adopt a transition rule providing a minimum of one year for conversion of distillation only to distillation and fermentation.

Ethanol Production Offers Important Benefits to CBI and Insular Territory Countries

Full-scale production of fuel grade ethanol offers substantial economic development opportunities for the Virgin Islands and CBERA beneficiary countries. Secretary of State Shultz has characterized fuel ethanol as the "most promising alternative use" for sugar grown in the region and elsewhere in Latin America. Ethanol production will provide a substantial number of jobs in manufacturing, transportation, and related activities, and offers one of the best means available of stimulating economic development in the region through incentives for trade with the United States.

From its Virgin Islands facility, CFC expects to suppy ethanol to markets in Europe and the Far East as well as the Southeastern United States.

CFC's Market in the Southeast Complements Domestic Ethanol Industry Efforts

CFC has successfully developed a significant market for alcohol blended fuels in the Southeastern United States, a region not served by the domestic ethanol industry because of the competitive price of gasoline, the general absence of state tax exemptions, and the cost of transporting ethanol from production facilities in the Midwest. Development of this market with ethanol produced in the Caribbean will help forestall refiner commitments to other octane-enhancing technologies, and preserve the Southeastern market for ethanol which can one day be supplied through domestic production when it is economical to do so.

Evolution Toward Independence From Tax Support

Through its development of ethanol/methanol gasoline blends, CFC is helping the market evolve toward economic use of alcohol fuels without the need for either state or federal tax subsidies. CFC currently markets alcohol blends in status which have no state tax subsidies, and, by the end of 1992, will be able to economically market ethanol as a cosolvent for methanol at a price competitive with gasoline. CFC believes that there is enormous market potential for such blends, and that the industry must move in this direction in order to meet the 1992 subsidy phaseout schedule established by Congress.

To accomplish this goal, Congress should:

(1) Reconsider section 274 of H.R. 3838 and retain the Alcohol Fuels Credit (the "Blender Credit") for use by profitable companies engaged in developing ethanol/methanol blends as gasoline octane enhancers. The Blender Credit will allow economical development of alcohol fuels using ethanol in percentages of less than 10%, whereas the excise tax exemption requires a minimum of 10% ethanol. The Blender credit is a necessay complement to the excise tax exemption, and both elements of current law must be retained.

(2) Urge the Environmental Protection Agency to adjust the Evaporative Index of the "DuPont Waiver" to remove impediments to the commercial blending of ethanol as a cosolvent with methanol for unleaded as well as leaded gasoline.

Alcohol Fuel Mixtures

CFC has relied on existing law and Customs Service rulings to participate in the importation, during 1985, of certain mixtures of ethanol with gasoline and other petrochemicals. The Company does not object to extension of the Section 901.50 duty to such mixtures, but requests that such legislation avoid retroactive application to shipments received in 1985 by virtue of withdrawal from the warehouse in 1986.

TESTIMONY OF DONALD G. DOIRON
PRESIDENT, CHEMICAL FUELS CORPORATION

Mr. Chairman, my name is Donald G. Doiron, and I am president of Chemical Fuels Corporation ("CFC"). My company, based in Chamblee, Georgia, is a producer, formulator, and distributor of alcohol blended fuels in the southeastern United States. I would like to thank you and the members of your Committee for this opportunity to make known my company's views concerning several of the bills before you today relating to the imposition of duties on certain ethyl alcohol used as fuel.

I am pleased that the Committee has provided this forum to air the important issues associated with fuel alcohol imports, including trade policy, domestic supply capability relative to overall national demand, tariff policy, and tax incentives. While still relatively new, the fuel alcohol industry represents a complex web of energy, agricultural, environmental, geopolitical, and trade considerations, and it is time that the Congress openly considered the various costs and benefits that attend it. The industry's development of alcohol blended fuels as a petroleum extender and octane enhancer has arguably entered its second phase, and, as with any other industry, its public policy rationale must respond to the changing realities and context in which it operates.

CFC Ethanol Production in the Virgin Islands

CFC is making a substantial investment in the construction of an ethanol fermentation and distillation plant in the U.S. Virgin Islands which will convert sugar feedstocks into fuel grade alcohol. In order to make this investment feasible, the Company must utilize the associated distillation facility independently to dehydrate 190 proof ethanol imported from other countries while the fermentation facilities are under construction. We expect that the distillation facility will be operable on or around April 1, 1986, and that the entire "A to Z" fermentation facility will be completed by the end of 1986.

In making this commitment, the Company has relied upon rulings by the U.S. Customs Service, recently reaffirmed, that azeotropic distillation of alcohol in the Virgin Islands is sufficient to meet the existing substantial transformation requirements of Headnote 3(a) to the Tariff Schedules of the United States allowing duty free importation of such ethanol into the United States.

CFC accepts the Committee's determination that simple distillation facilities alone do not contribute sufficiently to the economic development of the region. Consequently, it does not oppose a reasonable phase-out of duty-free eligibility for fuel grade ethanol which is only subjected to azeotropic distillation in beneficiary countries.

However, in order to maintain a continuity of supply for its Southeastern U.S. markets, the Company must be able to utilize its distillation apparatus to produce ethanol in the manner contemplated by the Customs rulings it has relied upon at least until its fermentation facilities become operational.

We are grateful for the Committee's acknowledgement, in the Committee Report to H.R. 3838, of the need for a reasonable transition period for conversion from dehydration only to full-scale production from sugar feedstocks. We urge that the transition rule allow at least one year for this conversion.

Economic Benefits to CBI Countries and Insular Territories

Full scale ethanol production facilities offer one of the best means of satisfying the intent behind the Caribbean Basin Economic Recovery Act (CBERA) enacted in 1983. In a recent letter to the Chairman of the Senate Foreign Relations Committee (a copy of which is attached), Secretary of State George Shultz noted that the development of meaningful markets for ethanol--the "most promising alternative use" for sugar--involved "major foreign policy issues." Secretary Shultz further stated, referring to the Caribbean Basin and Brazil, that "major U.S. interests are at stake in encouraging political and economic stability in these areas."

Not only will the construction and operation of CFC's St. Croix ethanol facility mean substantial numbers of direct and indirect jobs in the Virgin Islands, but the project's sugar procurement program will also benefit sugar-producing countries in the Caribbean region such as the Dominican Republic, St. Kitts, Guatemala, and others. Projects like CFC's are even more important in light of the severe sugar import restrictions made necessary by the passage of the "no cost" sugar program provisions in the recent Farm Bill.

CFC Market Strategy Complements Domestic Ethanol Industry

CFC has successfully developed a significant market for alcohol blended fuels in the Southeastern United States, a region not served by the domestic ethanol industry. Domestically produced grain-derived ethanol currently requires the support of state tax exemptions in addition to the federal exemption in order to be competitive with gasoline, and experts agree that this will continue to be the case well into the future.

In recent months, CFC has demonstrated that the important Southeastern market can be supplied with imported ethanol without adversely affecting market opportunities for domestic ethanol. In fact, by preventing widespread refiner commitments to competing types of lead substitutes for octane enhancement, increased usage of imported ethanol in the coastal regions of the U.S. where domestically-produced ethanol is not available should actually benefit U.S. producers and grain suppliers by "buying time" until their technologies advance and market circumstances warrant the domestic industry's expansion to the coastal markets.

Evolution Toward Independence From Tax Support

Congress wisely put a limit on the duration of the fuel alcohol tax incentive program, establishing a sunset date of December 31, 1992. While the domestic fuel ethanol industry's response to these incentives has been impressive, it is important for the industry to pursue marketing strategies that will enable it to compete in the gasoline marketplace without state or federal tax incentives or other types of subsidies on the schedule established by Congress.

To this end, CFC has established a highly successful pilot program of ethanol/methanol blending to optimize ethanol's value as a cosolvent for much lower priced methanol. As a lead substitute, ethanol/methanol blends will allow alcohol blended fuels to compete throughout the United States without the need for state, and ultimately federal, tax incentives. In addition, years of testing have demonstrated the environmental superiority of these blends by way of reduced tailpipe emissions of hydrocarbons, aromatics and carbon monoxide, thereby reducing ozone formation.

In the wake of EPA's 91 percent reduction in gasoline lead levels, with the substantial need for fuel alcohols as octane enhancers this entails, the orderly development of a commercial market for ethanol/methanol blends is of critical importance to the long-term growth of a domestic fuel alcohol industry. Congress can advance this important goal by doing two things:

(1) Preserve the Blender Credit. Congress should reconsider section 274 of H.R. 3838 and retain the Alcohol Fuels Credit (the "Blender Credit") for use by profitable companies engaged in developing ethanol/methanol blends as gasoline octane enhancers. Retention of the Blender Credit is imperative for the orderly commercial introduction of these blends since, unlike the excise tax exemption, it allows profitable companies the flexibility to use ethanol in a percentage of from 1 to 10%, rather than the minimum 10% required under the excise tax exemption. Retention of the Blender Credit would not increase tax expenditures, since credits used must be subtracted from any excise tax exemption credits. However, encouraging blending in this manner would result in a substantial improvement in the cost effectiveness of ethanol, and pave the way for marketing of economical alcohol blended fuels without any federal tax subsidies after their expiration in 1992. It should also be

emphasized that restoration of the Blender Credit would be welcomed by the highway community, since it would reduce revenue losses from the Highway Trust Fund by reducing the use of the excise tax exemption.

(2) Urge Extension of DuPont Waiver to Unleaded Gasoline. Congress should convey to the Environmental Protection Agency its strong interest in seeing the Evaporative Index (EI) to the "Dupont Waiver," which it approved early last year, adjusted to remove impediments to the commercial blending of ethanol as a cosolvent for methanol in unleaded gasoline. CFC's pilot program of ethanol/methanol blending is limited to leaded gasoline only, in part due to the restrictive effects of the EI criteria. As stated previously, the best way to assure long-term, widespread utilization of alcohol blended fuels without the need for federal and state government tax support--especially in non-agricultural states where sufficient state tax incentives do not exist--is to encourage the optimum utilization of renewably-derived ethanol as a cosolvent with inexpensive methanol. Such an approach affords the required volumes, pricing, and stable supplies of alcohol needed to make it a substantial player in the octane enhancement market nationwide.

Alcohol Fuel Mixtures

Although CFC has participated in the importation of mixtures of ethanol with gasoline and other petrochemicals under rulings of the U.S. Customs Service, the Company has no general objection to enactment of legislation which would extend the 901.50 duty to mixtures as well as pure ethanol. However, in light of the Company's past reliance on current law and Customs Service rulings to import certain blends which in the future may be prohibited by bills such as H.R. 1720 and H.R. 1566, we would respectfully urge that the effective date of any such legislation be carefully drafted to ensure that shipments received in 1985 are not subjected to retroactive imposition of a new duty by virtue of withdrawal from the warehouse in 1986.

Conclusion

Mr. Chairman, as a distributor and blender of alcohol blended fuels in the Southeast, CFC believes that its interests are complementary with, rather than opposed to, those of the domestic ethanol industry. We support the domestic ethanol industry, and we believe ethanol fuels offer important benefits to consumers and taxpayers throughout the United States.

Congress made a wise and necessary commitment to the domestic ethanol industry and its agricultural suppliers in enacting the ethanol tax incentives. Congress also made a wise and necessary commitment to important neighbors with enactment of the Caribbean Basin Economic Recovery Act in 1983. The benefits of alcohol blended fuels--especially in light of the substantial octane shortfall arising from EPA's recent 91 percent reduction in gasoline lead levels--deserve to be enjoyed nationwide, not just in the Midwest. Fortunately, these various objectives can be realized in a synergistic way, and the needs of CBI countries and insular possessions for economic development can be served without adverse effects on the domestic ethanol industry.

THE SECRETARY OF STATE
WASHINGTON

December 5, 1985

Dear Mr. Chairman:

I am writing regarding two sections of the Senate version of the farm bill (S. 1714) concerning administration of the sugar support program and an import quota on ethanol.

These provisions involve major foreign policy issues. Sugar is a key foreign exchange earner for countries of strategic importance to the U.S. -- including Central America, the Dominican Republic, the Philippines and such major debtors as Argentina and Brazil. A sugar derivative, ethanol, is a significant export for Brazil and a promising new export opportunity for several countries in the Caribbean Basin.

Major U.S. interests are at stake in encouraging political and economic stability in these areas. As the President and Vice President have indicated frequently, the Caribbean Basin Initiative is of vital foreign policy interest, and we do not want to undercut it by restricting the trade opportunities offered by it. Sharp reductions in U.S. sugar imports in recent years have contributed to economic distress in Caribbean Basin and other important countries and have made it more difficult for them to pursue the economic and political reforms necessary for self-sustaining growth and democratic development. Further reductions in access to the U.S. sugar market will exacerbate their foreign exchange and unemployment problems and could even lead to political instability, with the potential for major harm to our national interest.

Although the intent of this amendment is to reduce costs to the U.S. government, paradoxically its effect may be exactly the contrary. As the economies of strategically important developing countries decline, the requirement for U.S. economic assistance increases. This Administration -- and I believe the Congress also -- believes it is far more effective for the U.S. to promote sustained economic development through investment and trade than through increased dependence on U.S. economic assistance.

The effect of declining sugar quotas would be compounded if the ethanol import quota is retained in the farm bill. The U.S. would simultaneously be restricting opportunities for a

The Honorable
Jesse Helms,
Chairman,
Committee on Agriculture, Nutrition and Forestry,
United States Senate.

major traditional export and its most promising alternative use. Furthermore, such a quota is inconsistent with our international obligations under the GATT and violates our repeated pledges, taken with the other major trading countries, to resist protectionism and work toward a more open international trading system. Where ethanol is traded unfairly, other provisions of U.S. law should be used, rather than a quota which restricts imports from all sources, whether or not they are subsidized or otherwise unfairly traded.

Maintaining free and fair access to our market is a crucial part of this Administration's strategy in promoting our international economic and political interests. As we pursue a more open and fair trading environment for our own exports, our interests are best served by a continued commitment to keeping our market open to fairly traded goods. In addition, these provisions of the farm bill would impose costs on U.S. consumers far in excess of the benefit to U.S. producers.

For these reasons, I believe it is important for the U.S. national interest that these two sections be dropped from the farm bill. I hope I can count on your support and that of your colleagues on the conference committee.

Sincerely yours,

George P. Shultz

Chairman Gibbons. I have got to admit I don't recall what we did about the blender credit. That must have been one of those slips in the night in the Ways and Means Committee. That was in this last tax bill?

Mr. Doiron. Yes.

Chairman Gibbons. I hope somebody will take time to inform me what we did there on that.

Mr. Doiron. It is a very, very serious issue because if in fact the blender tax credit is not available wherein we can use percentages of ethanol with a cosolvent with methanol less than 10 percent, it would eliminate the industry's ability to take advantage of the very high octane and very low cost of methanol. It is essential if we are to——

Chairman Gibbons. What rationale did we publish for that learned decision by the committee, do you know? I am not aware of it.

Mr. Doiron. Somehow there was a conclusion reached, I take it, that said that there was no difference between having the tax incentive—or the excise tax exemption provide the 60 cents versus having the blender credit provide the 60 cents, and for that reason, why not get rid of one if the other one works.

But there is a very substantial and subtle difference in that thinking.

Chairman Gibbons. I am—I myself missed not only the subtleties but the whole thing. I don't know where I was that day. I might have been right here and missed it. Sometimes things happen fast around here like that.

Let's see, I will have to learn a little more about that before I can express much of an opinion on it.

[The following was subsequently received:]

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February 18, 1986

RECEIVED
FEB
Ways and Means
Subcommittee on Trade

Honorable Sam Gibbons, Chairman
Subcommittee on Trade
Committee on Ways and Means
1136 Longworth House Office Building
Washington, D.C. 20515

Re: Repeal Of Ethanol "Blender Credit" In H.R. 3838

Dear Mr. Chairman:

At the February 7 hearing on ethanol trade issues, during the testimony of Donald G. Doiron, President of Chemical Fuels Corporation, you expressed interest in the circumstances under which the Alcohol Fuels Credit (the "Blender Credit") currently available as an alternative to the federal gasoline excise tax exemption was proposed for repeal in H.R. 3838. I hope this letter will provide some clarification of the Blender Credit situation.

Repeal of the Blender Credit was adopted by the Ways and Means Committee as a purported compromise between the President's tax reform proposal, which would have eliminated both the excise tax exemption and the Blender Credit (except for certain grandfathered facilities), and the ethanol industry's proposal to retain both the excise tax exemption and the Blender Credit. Apparently, based on incorrect information, the staff of the Joint Tax Committee believed that elimination of the Blender Credit would achieve a significant revenue gain for the bill.

In fact, as Mr. Doiron testified (and as the Treasury Department has subsequently confirmed in its revenue estimates on tax reform options provided to the Senate Finance Committee), little if any revenue would be gained by eliminating the Blender Credit. In the absence of the

Blender Credit, all ethanol sales will go into uses which are eligible for the excise tax exemption, which, as you know, comes entirely out of the Highway Trust Fund. Continued availability of the Blender Credit, on the other hand, would mean that some of this product would be drawn into uses eligible for the Blender Credit (and ineligible for the excise tax exemption), as technology and markets develop for ethanol used as a co-solvent with methanol in gasoline.

Most importantly, elimination of the Blender Credit would take away from the ethanol industry the support it needs to evolve toward an industry that can operate without tax subsidies in time for the 1992 sunset of the existing incentives. The Blender Credit encourages movement toward use of ethanol as a co-solvent with high quality, low cost methanol in blends which can compete economically with straight gasoline.

Chemical Fuels Corporation now has underway a successful pilot blending program, under the supervision and with the support of the North Carolina Highway Department, which is demonstrating the value of such blends as safe, reliable and economical motor fuels. These fuels are not eligible for the federal excise tax exemption, because they use ethanol in less than 10 percent blends and the excise tax exemption requires a minimum of 10 percent ethanol.

Continued development of these economical blends requires access to the Blender Credit. Therefore, elimination of the Blender Credit removes the very tool Congress put in place to help the industry evolve toward self-sustaining economics.

We are asking the Senate Finance Committee to fulfill the original commitment of Congress to the ethanol industry by retaining both the excise tax exemption and the complementary Blender Credit through the 1992 sunset date established when these important incentives were adopted. We hope you will persuade your colleagues of the wisdom of that approach when the opportunity arises in conference.

Let me take this opportunity to thank you again for scheduling the February 7 hearings, which gave the ethanol industry an opportunity to clear the air of suspicions and misinformation about the intentions of some participants with respect to Caribbean ethanol production. Chemical Fuels Corporation fully supports the direction of the Committee in phasing in a requirement for full-scale fermentation in the Virgin Islands and CBERA beneficiary countries in order to qualify for duty-free importation of ethanol into the United States. The Chemical Fuels Corporation fermentation facilities will be operational by the end of 1986, and a reasonable transition period continuing current law treatment of dehydrated ethanol pending completion of those facilities will allow the company to bring the full benefits of economic development desired by the Committee to the Virgin Islands before this year is out.

If I can provide you with further information about either the operation of the Blender Credit or Chemical Fuels Corporation's Virgin Islands facilities, I would be more than happy to do so. Thank you again for your consideration of this important issue.

Sincerely yours,

Frederick H. von Unwerth

cc: Honorable Ed Jenkins
Honorable Byron Dorgan
Rufus Yerxa
Donald G. Doiron

Chairman GIBBONS. Mr. Koopersmith.

STATEMENT OF JEFFREY M. KOOPERSMITH, EXECUTIVE VICE PRESIDENT, RAJ CHEMICALS, INC.

Mr. KOOPERSMITH. Yes, Mr. Chairman.

We have submitted my statement for the record.

Chairman GIBBONS. We will put it all in.

Mr. KOOPERSMITH. I am grateful for you giving me this opportunity, and my name is Jeff Koopersmith. I am vice president of RAJ Chemicals.

We submit the proposed legislation before you today is excessively broad and as such should be substantially amended or withdrawn. The U.S. Department of the Treasury Customs Service has properly ruled that azeotropic distillation of ethanol alcohol from beverage grade to fuel constitutes substantial transformation and I feel that the Congress should abide by that ruling and abide by its previous legislation on these matters.

Customs should continue to accord tariff-free treatment on fuel-grade ethanol produced in CBERA beneficiary countries by azeotropic distillation upon direct importation into the United States. This tariff treatment furthers the congressional intent of promoting capital investment in the Caribbean Basin and also facilitates Congress' intent of one way trade into the United States from these qualified countries.

Mr. Chairman, you have heard testimony from my colleagues here. We have no investment in Jamaica or any CBERA country, but RAJ Chemicals would like the opportunity to be able to purchase product in the Caribbean and for that matter anywhere in this world.

RAJ Chemicals has chosen since the Brazilian source has been virtually cut off by legislation——

Chairman GIBBONS. By the tariffs.

Mr. KOOPERSMITH. By the tariffs. We have chosen to invest in the United States and presently are making an investment of about $20 million in Norfolk, VA, to build a grassroots fermentation plant because we feel that the technology available in the near future will be able to allow us to be able to produce ethanol in this country at some competitive rates with either Jamaica, or Brazil, or any other nation, for that mattter.

Chairman GIBBONS. Thank you, sir.

[The prepared statement follows:]

STATEMENT OF JEFFERY M. KOOPERSMITH, EXECUTIVE VICE PRESIDENT, RAJ CHEMICALS, INC.

Mr. Chairman, I am grateful to you and the Subcommittee for this opportunity to testify on a matter of great concern to ethyl alcohol producers and distributors. My name is Jeffrey Koopersmith. I represent RAJ Chemicals, Inc., a marketer and distributor of ethyl alcohol. We strongly oppose H.R. 1566 and H.R. 1567 (Congressman Leach's bills) and H.R. 1720 (Congressman Durbin's bill), as well as H.R. 4094, which was recently introduced by Congressman Michel. These proposed measures provide that (1) azeotropic distillation of ethyl alcohol from beverage grade to fuel grade would not constitute "substantial transformation" under the Caribbean Basin Economic Recovery Act of 1983 ("CBERA"), Pub. L. No. 98-67, and (2) imports of mixtures containing ethyl alcohol would be subject to tariffs of 60 cents per gallon and 3 percent _ad valorem_, as provided in TSUS Items 901.50 and 427.88, respectively.

RAJ Chemicals, Inc. submits that this proposed legislation is excessively broad and, as such, should be substantially amended or withdrawn. The United States Department of the Treasury, Customs Service has properly ruled that azeotropic distillation of ethyl alcohol from beverage grade to fuel grade constitutes substantial transformation, thereby satisfying the current test for tariff-free treatment under CBERA. RAJ Chemicals, Inc., however, does not support the tariff-free treatment of all imported ethyl alcohol transformed to a fuel grade product through azeotropic distillation within CBERA beneficiary countries. Such product also must meet the more stringent "35 percent of appraised value added" test under CBERA before qualifying for tariff-free treatment when directly imported into United States Customs Territory. In addition, as provided under current law, ethyl alcohol production from grassroots fermentation facilities in a CBERA beneficiary country should continue to qualify for tariff-free treatment when directly imported.

Customs should continue to accord fuel grade ethyl alcohol, produced in CBERA beneficiary countries either by azeotropic distillation or grassroots fermentation, tariff-free treatment upon direct importation into the United States. This tariff treatment furthers the Congressional intent of promoting capital investment in the Caribbean Basin and also facilitates Congress' intent of one-way trade into the United States from those qualified countries. No one would deny the need to promote Caribbean Basin countries' need for capital investment.

Ethyl alcohol produced in a grassroots fermentation facility located in a beneficiary country constitutes a new or different article of commerce from that which has been grown, produced, or manufactured in that country. Through this fermentation process, at least 35 percent of the appraised value of the ethyl alcohol imported directly into the United States results from materials and direct processing costs originating in the beneficiary country. Thus, production from a grassroots ethyl alcohol facility would satisfy the critical tests necessary to obtain tariff-free treatment under the CBERA. Similarly, fuel grade ethyl alcohol achieving beneficiary origin status through substantial transformation, such as azeotropic distillation, and satisfying the 35 percent of appraised value test, also qualifies for CBERA tariff-free treatment. For these reasons, tariff-free treatment for any ethyl alcohol meeting the CBERA tests constitutes a legitimate tariff practice and is clearly in the interests of the United States and CBERA countries.

The legislative history of CBERA clearly demonstrates that the statute's tariff-free treatment constitutes a direct response to the "economic crisis which threatens political and social stability throughout the region". 1983 U.S. CODE CONG. & AD. NEWS 643, 644 (H. Rep. No. 266, 98th Cong. 1st Sess.). Declining prices for the regions major exports such as sugar, coffee and bauxite, "exacerbates their deeply rooted structural problems, and causes serious inflation, high unemployment, declining gross domestic product growth, enormous balance of payments deficits, and pressing political crises". Id.

The Caribbean Basin Initiative ("CBI") program, established by the Act, consists of "integrated, mutually reinforcing measures in the fields of trade, investment, and financial assistance to address both emergency problems and long-range economic development. The program is designed to foster self-reliance and its success rests primarily on implementation through local and foreign sector initiative. The centerpiece of the U.S. program is the offer of one-way free trade under Title I of the legislation, providing the most favorable and secure long term access possible to the U.S. market." Id. Grassroots and azeotropic distillation facilities represent multi-million dollar capital investments in beneficiary countries and create hundreds of new jobs, thereby reducing high unemployment. They also provide saleable ethyl alcohol products which return substantial revenues to these countries. These revenues would increase domestic product growth, reduce balance of payments deficits and create liquid cash reserves for use in future investments within those nations. These ethanol facilities would promote long term economic independence and healthy political and social structures for these countries.

The ethyl alcohol from CBERA countries imported into the United States would assist in filling the large domestic gap of alcohol fuels necessary to meet motor gasoline octane requirements in this country due to the Environmental Protection Agency's ("EPA's") lead phasedown schedule. Ethyl alcohol production from facilities located in beneficiary countries, thus, is directly within the spirit of the CBERA and a vital supplement to domestic supplies.

RAJ Chemicals, Inc. further submits that the proposed legislation, which would impose a tariff of 60 cents per gallon plus 3 percent *ad valorem* on any mixtures containing ethyl alcohol for fuel use is excessively broad and potentially harmful to the United States motor fuels industry. These bills provide no percentage limitation on the amount of ethyl alcohol contained in such a mixture for the imposition of the high TSUS Item 901.50/427.88 tariff treatment upon each blended gallon. We must not act to defeat our policy of eliminating the pollution caused by lead additives.

Under the proposed legislation, a gallon of finished gasoline containing even *de minimis* amounts of ethyl alcohol (*i.e.*, much less than the 10 percent limit for gasohol) would be subject to the high tariffs. Customs has ruled that under present law, gasoline mixtures containing 10 percent ethyl alcohol qualify for the 1.25 cents per gallon motor fuels treatment under TSUS Item 475.25, because such blends are "chiefly used" as motor fuel within the United States. Furthermore, unleaded gasoline blends containing up to and including 10 percent ethyl alcohol comply with EPA's gasohol waiver restrictions. The Company submits that, at the least, Congress should amend the proposed legislation to impose the high tariff treatment only on mixtures of unleaded gasoline containing more than 10 percent ethyl alcohol.

Congress, however, should not impose any percentage limitation on the amount of ethyl alcohol contained in leaded gasoline blends. Leaded gasoline blends with more than 10 percent ethyl alcohol will be chiefly used as motor fuel in the near future. EPA imposes no waiver restrictions on these leaded gasoline blends. Such blends, which are needed to boost octane levels under the restrictive EPA lead phasedown schedules commencing July 1, 1985, frequently will require more than 10 percent ethyl alcohol to serve this purpose. We believe that leaded gasoline containing unlimited percentages of ethyl alcohol should receive the tariff treatment accorded under TSUS Item 475.25 or other applicable tariff provisions, depending upon whether the product meets the various tests provided under those respective tariff regulations, without the additional 60 cents per gallon tariff of TSUS Item 901.50.

In addition, denatured ethyl alcohol blends should not be accorded TSUS Items 901.50/427.88 treatment.

Finally, I have come here today to speak about reliable and fair trade policies. For the past year numerous pieces of Federal Legislation have crossed your desks and mine regarding fuel ethanol, industrial ethanol and ethanol mixtures from abroad and now, specifically, from CBERA beneficiary countries.

These bills, introduced to protect our domestic industry, are also blind to macro-economics -- or simply a policy of open trade endorsed by the country for many decades. My company is, at this instant, engaged in investing between 15 and 25 million dollars in a grass roots facility in the Mid-Atlantic states. Because of new technologies in the fermentation process, we believe that we will be able to produce ethanol at competitive world market prices. I also proudly state that we built our business, an American business through trading and distributing foreign, as well as domestic ethanol. As you all know, any business must seek out quality supplies at the lowest prices. Congress and the Federal Government generally have initiated competitive bidding practices and seek supplies through quality/price controls.

Why then, does H.R. 4094 seek to close off yet another option for supply -- an option dominated by American investment? Are we to imagine that none of us in this room buy foreign products? Are we to imagine that the largest American corporations do not seek components from abroad?

Yet, our industry continually faces losses of one purchase option after another. Companies like mine have been portrayed as "foreign companies" because we go to world markets seeking product. We are not foreign companies. We are American companies investing large sums of money in our country by way of excise, sales, property and income taxes, tariffs, the wages of our employees and capital improvements -- all reinvested in the United States.

Foreign product is not sought because of price only, it is also sought to fill the gap between domestic supply and domestic demand. Even our large domestic colleagues must admit that they cannot supply the growing demand. Ergo, without some foreign product the national scope of this industry would cease to exist. Domestic producers, including ourselves, really do need the option of purchasing additional supplies to augment U.S. production. Changes in the price and availability of energy and feedstocks sometimes make grassroots production alone economically unfeasible, unless the domestic producer is so large that it is outside the normal stream of commerce.

If we are to continue to follow EPA-required lead phasedown in gasoline to help protect our environment -- and to offer the American people the highest octane gasoline at the lowest prices -- we should continue to leave viable options open. Options like these do not threaten the domestic industry. All domestic producers have at least investigated the purchase of foreign product and many buy it on a regular basis for the same reasons outlined above.

RAJ Chemicals has saved its profits and is reinvesting those funds into the United States, its country, with grassroots production facilities in the Mid-Atlantic. Why then do we also support a more open trade policy with regard to ethanol fuels and mixtures? The answer is simply that it is good business sense for America and for us to make profits which are in turn reinvested in America.

Thank you. I am prepared to attempt a response to any questions Members may have.

Chairman GIBBONS. Mr. Brooks.

STATEMENT OF FREDERIC H. BROOKS, TREASURER, CARIBBEAN/CENTRAL AMERICAN ACTION, AND CHAIRMAN OF THE BOARD, MacGREGOR SPORTING GOODS

Mr. BROOKS. My name is Frederic Brooks. I am chairman of the board of MacGregor Sporting Goods.

Chairman GIBBONS. You make a mighty fine product.

Mr. BROOKS. Thank you, sir. I hope that is for the record.

Chairman GIBBONS. Yes, sir.

Mr. BROOKS. And we have no direct financial interest in Jamaica. As a matter of fact our only direct financial interest in the Caribbean is our sizable operations in Haiti.

I am appearing before you today in my capacity as an officer and member of the executive committee, Caribbean/Central American Action. The organization which I represent includes well over 100 American, Caribbean, and Central American firms. It is an independent, nonprofit group whose chairman is David Rockefeller and whose mandate is to promote private-sector-based economic development in the countries of the Caribbean Basin.

We seek to stimulate trade and investment, foster responsible business leadership, and support enlightened policies on the part of the U.S. Government toward the region.

Mr. Chairman, if investment flowed easily into the countries of the CBI there would have been no need for this committee to have carefully sheparded the Caribbean Basin Economic Recovery Act through the Congress 2 years ago. CAA, as you know, was a most active advocate in that process.

By virtue of that act we invited American firms to invest in the Caribbean Basin with reliance on the CBI benefits being maintained in place for 12 years.

As a matter of fact, in differentiating CBI from the GS program, those in our Government who have been carrying the message of CBI have utilized the permanence of CBI, the 12-year unchanging standard of CBI, as one of its greatest advantages over the GSP program, which is available for developing countries all over the world.

The entire usefulness of the CBI as an investment promotion tool depends upon its credibility and reliability in the eyes of the business community. Since there is no such thing as an act of Congress that cannot be overturned by a subsequent one, the credibility of a 12-year program like the CBI depends upon the will to remain faithful to the original intent displayed by the Congress.

The three bills before this committee today are designed specifically to repeal part of the benefits granted under CBI by adding a further exclusion you did not see fit to include when the original legislation was passed.

My purpose today is not to insist that over 12 years there should be no changes to the original legislation. Changes will undoubtedly be needed which, over time, are considered to serve the interest of justice and the benefit of all parties. I do suggest, however, that no modificaitons to the CBI be taken lightly in mere response to the entreaties of competing interests.

I would like to suggest some brief guidelines to when and how these modificaitons may be made.

One, a strong presumption must be established the CBI remain intact for 12 years against any competing interest. Two, the administrative procedures set up by the act to rule on technical questions should be respected.

Three, the Congress should not act as an appellate body. Four, a strong signal should be sent to the administration that the Congress intends that CBI benefits be interpreted as broadly and inclusively as possible at the administrative level. And, five, Mr. Chairman, changes to the law at this stage should come only after a far-reaching inquiry carefully takes into account the positions of the beneficiary countries themselves.

With respect to the specific issue of ethanol imports let me again note that I am in the sports equipment business and have no pretentions of speaking on the technical merits of the sugar refining industries. We are concerned because of the broader public policy issue implicit in this discussion. I would like to make several points against the background of the principals just mentioned.

One, each of these bills intentionally removes from CBI benefits certain exports currently recognized under the law. There should be a strong presumption against such a partial repeal of the act and the burden of persuasion should be heavy on the backers of such initiatives.

Two, the issue of substantial transformation, according to the criteria set up by the act becomes a technical question to be considered by the U.S. Customs Service.

That agency has now twice considered the issue raised in the bills, and at both times concluded the process was a legitimate substantial transformation under the law. This committee created a process whereby domestic industries could plead hardship and seek relief. These two processes should be respected, not circumvented as the proposed legislation would do.

Three, the Reagan administration has adhered to a policy of broadly interpreting the CBI benefits. I was in attendance when Vice President Bush reiterated this principle only 2 months ago at the Miami Conference on the Caribbean with 2,000 people from the region attending. Favorable action on the bills before you today would send an opposite signal to the administration and to the countries of the Caribbean Basin.

Four, the signal to the U.S. business community would be even more devastating. Investors would certainly have to think twice before relying upon the law when considering an investment in the CBI.

Five, it would be particularly tragic if the entire CBI principles were to be undercut at the initiative of a domestic industry which does not seem to need protection. Even I, who know little about the ethanol business, have to ask what the problem is when a domestic industry whose total production in 1984 of 430 million gallons fell short of demand by over 100 million gallons, when projected demand this year is a result of EPA's phaseout of lead in gasoline has been projected as high as 8 billion gallons and the plant in Jamaica that is causing so much concern is only capable of producing 20 million gallons a year.

Finally, Mr. Chairman, some proponents of this restrictive legislation have advanced the argument that a stricter transformation test would actually benefit the CBI nations themselves.

This may or may not be the case. I would propose that we ask the countries themselves how they see the issue and not take their competitors' words for it.

In closing, Mr. Chairman, given the particular events in Haiti of this morning, I think the timeliness of making a change in the law which might undercut the effectiveness of the CBI legislation would be most unfortunate.

Thank you, very much.

[The prepared statement follows:]

STATEMENT OF FREDERIC H. BROOKS, CHAIRMAN OF THE BOARD, MACGREGOR SPORTING GOODS, AND TRUSTEE AND TREASURER CARIBBEAN/CENTRAL AMERICAN ACTION

Mr. Chairman and Members of the Committee:

My name is Frederic Brooks, and I am chairman and CEO of MacGregor Sporting Goods. It is a pleasure for me to come before this Committee again, after having had the opportunity just last summer to share some thoughts with you on the 936 issue. Today's topic--ethanol--is technically very different, but the underlying principle is the same: Because the economic regeneration of the Caribbean Basin is so vital to our own nations's security and prosperity, any unnecessary legislative changes that undermine the spirit or letter of the Caribbean Basin Initiative should be scrupulously avoided.

My own role today, as when we met last, is as a representative of Caribbean/Central American Action, of which I am the treasurer, and also as an American businessman with experience and interests in the Caribbean. I note for the record that my own company's business has nothing to do with ethanol, sugar, alcohol or any other product or process affected by the proposed legislation, so I am not speaking as an "interested party." My interest--the interest of C/CAA and, I believe, of the business community generally--is to see the integrity of the Caribbean Basin Economic Recovery Act (CBERA) remain intact.

By now, Mr. Chairman, I feel we all know one another, but let the record again state that the organization I represent--Caribbean/Central American Action--is an independent, non-profit organization currently chaired by David Rockefeller and funded by contributions from about 100 U.S. firms. It was founded in the late 1970's by U.S. business leaders concerned about the future of the Caribbean Basin, and anxious to promote private-sector based economic development there. We do that by stimulating trade and investment, fostering responsible business leadership within the countries, and supporting enlightened policies on the part of the U.S. Government toward the region.

Two years ago, when this committee after very careful deliberation successfully shepherded through Congress the Caribbean Basin Economic Recovery Act, C/CAA was one of its most active advocates in the private sector. We supported the CBI--and I believe you did too--because we saw the need to deal with an urgent situation, which has not changed. These were and are the facts:

--Caribbean Basin economies, without some immediate outside intervention to open a new window of opportunity, were in serious trouble.

--Their economic collapse and the political chaos or ideological vulnerability likely to follow would be extremely damaging to the national interests, both economic and security, of the United States.

--The U.S. was in a unique position to provide that window of opportunity by opening new trade and investment incentives.

--Our own national interest required us to do so.

THE CBI--A TWELVE-YEAR COMMITMENT

The center piece of the CBI as it emerged was its twelve-year-duty-free entry for products made or substantially transformed in beneficiary Caribbean Basin countries. This benefit was designed not only to guarantee markets for existing Caribbean products, but to create an incentive for U.S. firms to invest in Caribbean enterprises designed to take advantage of that market. The incentives derive not only from guaranty and access to the U.S. market, but from the comparative advantage over products imported from non-CBI countries.

The purpose of encouraging new investments in the region was to create employment and generate foreign exchange earnings in the beneficiary countries, thus enabling them to achieve the economic regeneration your own investigation had determined was necessary for them, and potentially for us.

Mr. Chairman, if investment flowed easily and extensively into these countries as a natural result of the region's attractiveness and the forces of the marketplace, there would have been no need of this legislation. And if one did not presume that its existence would make a substantial difference in the investor's decision to invest, passing it would have served no purpose. As it is, we are inviting American firms to invest in the Caribbean Basin in specific reliance on the fact that CBI advantages will be in place for 12 years.

The 12-year commitment built into the CBI is a unique and critical feature. It recognizes that investors, whether from overseas or from the business communities of the countries themselves, need to be able to project far enough into the future to allow for the typically 2-year start-up phase plus a long enough period of operation and sales to recoup their investment. No corporation faithful to its shareholders, and no individual entrepreneur risking his personal fortune, would invest on the basis of legislatively created market advantages that could be negated before the operation even comes on stream.

The entire usefulness of the CBI as an investment-promotion tool depends on its credibility and reliability in the eyes of the US business community. Since in fact we all recognize that there is no such thing as an act of congress that cannot be overturned by a subsequent one, the credibility of a 12-year program like the CBI depends on the will to remain faithful to the original intent displayed by Congress. Particularly in these early years, it is essential that Congress send to the business community a clear signal that, having debated these issues for two years and arrived at certain exclusions from the CBI program, process of building in further exclusions has stopped.

GUIDELINES FOR CBI MODIFICATIONS

Mr. Chairman, three of the bills before this committee today for your consideration are designed specifically to repeal part of the benefits granted under the CBI by adding a further exclusion you did not see fit to include when the original legislation passed. I am referring to H.R. 1566, H.R 1567, and H.R. 1720, each of which is intended to strip duty-free treatment from certain exports of ethanol from the Caribbean.

Considering the fact, Mr. Chairman, that this may not be the first and will certainly not be the last attempt to persuade the members of this committee to dilute the CBI during the course of its 12 years, it would seem valuable for the committee to establish some guidelines for how it intends to deal with proposed modifications to the act. My intention today is not to insist that over 12 years, no proposed amendments to the CBI will ever arise. I do insist, however, Mr. Chairman, that no modifications to the CBI should be undertaken lightly, in mere response to the entreaties of competing interests, or without a determination on your part that the purposes of the original act will thereby be better served.

We would like to recommend to you the following points for your consideration as guidelines in evaluating proposed CBI modifications such as those before us today:

One. A strong presumption should be established that the integrity of the CBI is to remain intact for the 12 years against any encroachment by competing interests, with the burden of proving the importance and merit of making an exception to the rule clearly on the proposer.

Two. Congressional action should reflect respect for the integrity of the administrative process set up by the act, with a presumption that rulings on technical questions reached after due process by the agencies to which such decisions have been delegated under the act will be upheld. This committee must not hold itself out as an appellate body before which disappointed interests can re-litigate their technical issues in an effort to get a political decision narrowing the scope of the act.

Three. A clear signal should be given to the executive branch that Congress intends the benefits granted by the CBI to be interpreted as broadly and inclusively as possible at the administrative level.

Four. Strong weight should be given to the factor of future reliability to investors, and particularly to actual reliance by current investors, in any matter where the credibility of the CBI's incentives to the business community is at stake.

Five. To the extent that the issue is posed as a request for protection by an aggrieved domestic industry, tampering with the CBI should not even be considered where there is no indication that U.S. enterprises will in fact be harmed, or where the domestic industry is itself divided between firms claiming to gain or lose by keeping the CBI intact.

Six. To the extent that the issue is posed in terms of the impact on the beneficiary countries--whether they would be better served by the CBI as currently enacted and interpreted, or by a proposed modification--no decision to modify existing law should be made without thorough consultation with the countries themselves.

And finally, Mr. Chairman, since the purpose of the CBI is to deal with problems and improve conditions within the beneficiary countries, I think any decision on the upholding or restricting of benefits under the CBI should take into account not only the CBI itself but the overall impact of U.S. policies on the countries and industries in question.

With a set of principles such as these as guidelines, Mr. Chairman, we feel your committee would be in a position to weed out expeditiously those proposed amendments that simply re-open the debate of two years ago, creating uncertainty in the minds of investors over the program's permanence. You would then be able to focus your attention instead on any circumstances that may arise where some modification in the CBI would actually improve its ability to achieve its originally intended impact.

THE CBI AND ETHANOL

At this point, Mr. Chairman, let me turn to the specific case of these ethanol bills. Let me start by saying that I am in the sports equipment business and have no pretensions to come before you with technical knowledge of the sugar, alcohol, or refining industries. I can speak only as you can, from the point of view of broad public policy. However, all of us at C/CAA are convinced that some very broad public policy issues are at stake here.

I would simply like to point out what we see as key elements of the ethanol issue in light of the seven principles I have just set forth.

First, each of these bills clearly and intentionally removes from the benefits of the CBI certain industries and exports which under current law enjoy those benefits. We feel that respect for the integrity and credibility of the act requires that we enter these deliberations from the outset with a strong and openly held presumption against this kind of partial repeal of the act. The burden of persuasion on the backers of these bills ought to be significantly heavier than if the same issues were being debated two or three years ago.

Second, what we have here is basically not a proposed exclusion of a whole industrial category, but an attempt to narrow legislatively the inclusiveness of the act's concept of "Substantial Transformation." Clearly the intent of Congress in this provision was to insure that real income and employment benefits accrue to the beneficiary countries by operation of the duty-free policy, and that they could not simply be used for relabeling and transshipment by third-party exporters in nonbeneficiary countries, hoping thereby to fraudulently appropriate the benefits of the act. No reasonable person would quarrel with this principle.

However, the question of what constitutes substantial transformation according to the criteria set up in the act at some point becomes a technical question answered differently in each industry. Under the act, the authority to decide such technical questions is given to the U.S. Customs Service. That agency has now considered twice the very issue raised by these bills--once at the request of a company planning a major investment, and a second time at the request of protesting competitors. Both times--the second time after inviting arguments and comments from all sides--customs reached a determination that the disputed process did indeed qualify as substantial transformation under the act.

For this committee to come on the rebound and effectively overturn that decision at the instigation of the same interests who lost out in the administrative forum would create an unfortunate precedent. Prospective investors with any doubts needing to be resolved before proceeding with their commitment would never be able to rely on the case being closed.

This committee in its wisdom created administrative processes not only for the determination of questions such as substantial transformation, but for domestic industries to plead hardship and seek relief. These processes should be respected--not circumvented as the proposed legislation would do.

Third, overturning this particular decision would not only violate sound procedure by second-guessing customs on a technical decision properly delegated to it, but would send a most unfortunate signal to the Administration on the spirit and intent of the CBI. The Reagan Administration, in its reiteration to the Caribbean Basin countries of its full commitment to the CBI, has stated its policy of interpreting and applying CBI benefits as broadly as possible, to the benefit of the countries. I myself heard Vice-President Bush re-state that commitment in eloquent and unequivocal terms at C/CAA'S Annual Miami Conference on the Caribbean just two months ago.

We at C/CAA believe this liberal interpretation is consistent with the objectives and spirit of the act, and to the best of my knowledge, Mr. Chairman, with the intent of this committee. If that is indeed the case, your approach to legislation such as this should send the Administration a clear signal that Congress is in accord with the approach the President has taken. Favorable action on the bills before us today would do the opposite.

Fourth, if the signal to the administration would be unfortunate, the signal to the business community would be nothing short of disastrous. We have here a case where an actual investor, acting in reliance on an administrative finding that its investment would qualify under the CBI, proceeded to construct a 15 million dollar complex in a CBI country--in this case, Jamaica--which is now in actual operation employing some 30 Jamaicans and projected to return 5 million dollars per year to the Jamaican economy.

The effect and intent of this legislation is to put this enterprise out of business, put its employees out of work, deny Jamaica the foreign exchange it would now earn, deprive an American firm of the benefit of its investment, and jeopardize over 50 U.S. jobs tied into the overseas operation. It would also stop dead in its tracks another similar enterprise also ready to proceed in Jamaica. And it would, by its intent, prevent any similar ventures from being undertaken in contemplation of the CBI anywhere in the region. And it would certainly cause potential investors in any industry--particularly non-traditional industries where the customs classifications might still be ambiguous--to think twice before relying on the CBI.

This ''Reliance'' principle--the 4th in my listing--is utterly critical in the case of the CBI. Much more is at stake here than the outcome of the ''Ethanol Issue.'' The company triggering this case did exactly what the CBI is intended to get U.S. firms to do--make a substantial investment in a Caribbean country in response to advantages the CBI promises for 12 years.

The point was clearly stated by then-U.S. Trade Representative William Brock in opposing the move to overturn the customs ruling in this case: "The success of the CBI clearly rests on the certainty which it gives to investors. In the case of ethanol, as in any other, our primary concern is maintaining that degree of certainty. He said "overturning the favorable ruling would not only undercut the particular investment at risk in Jamaica, but ''would undercut the CBI as a whole.'' That states C/CAA'S own view exactly.

Fifth, it would be particularly tragic to undercut the whole CBI in an effort to protect a domestic industry that, by nearly all accounts, does not need protection. I'm not trying to out-guess the industry experts, and I'm sure you'll derive the accurate figures by listening to their various estimates. Nevertheless, even a layman in these matters has to ask what the problem is when a domestic industry whose total production in 1984 of 430 million gallons fell short of demand by over 100 million gallons, when projected demand this year as a result of EPA's phase-out of lead in gasoline has been projected as high as 8 billion gallons, and the plant in Jamaica that is causing so much concern is only capable of producing 20 million gallons a year.

Sixth--and I think this point is particularly important--since the CBI was designed to benefit the countries of the Caribbean Basin, I don't think we should do anything to dilute it at the request of domestic interests before taking the time and effort to find out what the people in the Caribbean think about the proposed change. In this case, some proponents of this restrictive legislation have been advancing the argument that a stricter transformation test would actually benefit the CBI countries because any ethanol operations would have to use Caribbean raw materials rather than third-country imports. Mr. Chairman, this might be the case or it might not. But let's ask them--the private-sector and public-sector leaders of the CBI countries--and not take their competitors' word for it.

Mr. Chairman, there's a lot of interest in the Caribbean about the potential use of Caribbean sugar cane as raw material for ethanol. We at C/CAA find the prospects quite exciting. But the technology is not now in place on any reliable scale. Perhaps within a couple of years that will change. But what is the best path from here to there?

Which company is more likely to start refining Caribbean-sourced alcohol into ethanol--one that has to come in and build a plant from scratch and rely on an unproved source of supply, or one that's already there, knows the country, is in production, and can take advantage of fall-back sources of supply while Caribbean suppliers phase up to full commercial reliability? Which is better for a host country--to have a final transformation plant now, from which it derives some employment and significant income, or to wait until it can produce ethanol from start to finish before getting any piece of the action in the current ethanol demand boom? How can Caribbean sugar producers best be attracted into the ethanol field? How can the U.S. best help?

Mr. Chairman, I'm not posing any of these as rhetorical questions from which everybody is supposed to figure out the intended right answer. I'm posing them as legitimate questions for which neither you nor I have answers, for which U.S. competitors are not qualified to give us answers, and on which we need to hear a lot more from the Caribbeans themselves before we start cutting back the CBI supposedly for their own good.

Finally, Mr. Chairman, reference to the Caribbean sugar industry brings me to the seventh and last principle--the need to consider the impact of proposed CBI changes in light of the broader impact of U.S. policies on the needs of the region.

The Caribbean sugar industry is undergoing severe economic difficulties. Once a reliable mainstay for the single-commodity economies of several countries in the Caribbean Basin, the industry has been devastated by world market prices and limited by the restrictive U.S. quota system. For some countries, the declines they have suffered in income from sugar exports have more than wiped out their net gains from the CBI.

Since this is the case, Mr. Chairman, and our government has not seen fit to grant them relief in our sugar import policy itself, we should be particularly careful to take their needs and wishes into full account in weighing the question of the treatment of the ethanol industry under the CBI. It represents our one other major opportunity to have a helpful impact on one of the region's most important industries. The question of how ethanol refining and Caribbean sugar industry potential come together is, as I have indicated, a complex one, with potentially enormous consequences for the region's future. Let's not rush to foreclose any options before full consultations with our CBI allies.

Mr. Chairman, earlier I suggested seven tests on which to judge proposed revisions of the CBI. The bills before this committee today are indefensible on each one of those grounds. They contravene both the letter and the spirit of the CBI. In the interest of our friends in the Caribbean Basin and their just aspirations... in the interest of democracy and security in the closest part of the Western Hemisphere... in the interest of our own economy which benefits so much from Caribbean trade... C/CAA urges this Committee to table these bills permanently. Thank you, Mr. Chairman.

Chairman **Gibbons**. I want to thank all of you. I must say I don't know much about the properties actually carried on here. Azeotropic, that is what we are talking about. Whether what goes on in that amounts to a substantial transformation. What I understand is that it takes ethanol that has, what—is it 190 proof or 190 proof alcohol and turns it into 199 proof alcohol. It takes out some water. You believe that is a complicated process.

Mr. **Vind**. It is a very difficult process because there is a bonding created between the ethanol and the water which is called a azeotrope, which is a chemical term for products at similar boiling points, they cannot be separated by a simple distillation process. In the azeotropic distillation process a third chemical is added. Normally it is benzine. It can be other types of chemical compounds which can be used. The benzine then serves as a catalyst would in a refining operation.

Benzine is introducted in at very very high temperatures, the benzine then separates the water from the ethanol, the benzine water solution then is stripped off in an entrainer column, the pure ethanol goes one way, the benzine-water solution goes another way.

These are further separated, the benzine is then recycled back through the system. This is a very shorthand approach at how the system works. It cannot be accomplished through a normal distillation process——

Chairman **Gibbons**. Even the normal addition of heat will not——

Mr. **Vind**. That is correct.

Chairman **Gibbons**. There is no way by adding more heat to——

Mr. **Vind**. That is absolutely correct, Mr. Chairman.

Chairman **Gibbons**. Because the alcohol——

Mr. **Vind**. The alcohol and the water would boil off together.

Chairman **Gibbons**. So you have to go to this process that you described.

Mr. **Vind**. Yes, sir.

Chairman **Gibbons**. And it is your position and apparently Customs' position that this amounts to the substantial transformation?

Mr. **Vind**. Yes, and I believe there are people here from Customs who can testify to that, or certainly they can bring the experts over. I want to express for the record again this has undergone months of scrutiny.

The 516 petition was filed by the domestic industry prior to our importing 1 single gallon back in March 1985. And the ruling was not rendered, the final ruling was not rendered until November 19, so there was approximately 8 months wherein testimony was taken for the record.

The U.S. Customs Service literally waded through thousands of pages of testimony and comments by, I don't know how many commentors there were. It was probably up in the hundreds, and the preponderance of evidence conclusively demonstrated this is a substantial manufacturing process.

This, by the way, this same test was upheld by the appellate court and by the U.S. Supreme Court on substantial transformation relating to such things as sewing machine needles and other types of things. The substantial transformation process includes, Mr. Chairman, not just the manufacturing process itself, but the creation of a new and different article of commerce.

The wine alcohols or the 190 proof alcohol simply cannot be used in the United States as a component for gasohol blending because you will have a phase separation which is the same problem you were mentioning. You get this type of thing and the cars, engines simply will not run. It must be virtually water free in order to be utilized as a component for gasoline blending.

Chairman **Gibbons**. Have your cases been all through the appellate part of the commerce—I mean of the Customs operations—has anybody tried to take you to court on this case?

Mr. **Vind**. Yes. We have been notified through the publishing of something in the Federal Register that domestic interests will now be going to the Court of International Trade and they will be trying this before the courts. We are prepared, of course, to serve—they are not actually suing Tropicana, Mr. Chairman, they are threatening to sue the Customs Service. We, of course, serve in an amicus role in that case. We spent over $400,000 last year just defending our position.

Chairman **Gibbons**. In building a plant from scratch that would take sugarcane, say, all the way to 199 proof alcohol, you would have to have one of these towers; is that right?

Mr. **Vind**. You would have to be able to remove that final 5 percent regardless of the source of your feed stocks or where the fermentation took place.

Chairman **Gibbons**. There is no other process by which you can——

Mr. **Vind**. There is a process called molecularsieve technology which is relatively new. I understand there are some companies who are contemplating the installation of molecularseive technology. Our process does not employ that.

A molecularseive is basically like a reverse osmosis—it separates the water through a sieve type process.

Chairman **Gibbons**. And the whole process of turning alcohol—sugarcane into fuel grade alcohol, what percentage of the cost of the conversion is represented by this process?

Mr. **Vind**. The domestic industry would have to answer that. I do not have that knowledge. I can tell you what it costs us, which is substantially over 35 percent of the value of the imported product. I do not know what is spent. I have heard numbers from—as low as 5 percent to as high as 30 or 40 percent. We are spending well over 35 percent. I don't know, Mr. Chairman.

Chairman **Gibbons**. Mr. Frenzel, do you have questions.

Mr. **Frenzel**. I want to thank the panel for its help before the subcommittee. Mr. Chairman, a moment ago I asked for unanimous consent to include material in the record. It seems to me more appropriate that it be included at the conclusion of the testimony of this panel than where I made the request.

Chairman **Gibbons**. All right. We will ask the staff to put it in the right place.

Mr. **Frenzel**. I hope we will be able to do it. The company making that test has the, if not the same problem, a similar problem to Tropicana, and its test will be I think quite similar.

Mr. Vind, the burden of your testimony, or at least part of it, in refutation of the panel that appeared beforehand, was that they dismissed the azeotropic distillation process as a mere wringing of a little water out of the product and you were trying to show us through pictures and otherwise that this is an expensive chemical process whose cost and operations can be easily detailed.

Mr. **Vind**. That is correct, sir.

Mr. **Frenzel**. While the result may be to remove water, it isn't quite as easy a process as may have been described. Is that a correct characterization of what you are suggesting?

Mr. **Vind**. Yes.

Mr. **Frenzel**. You are also saying that your investment was made, at least partly, because of the new U.S. initiative in the Caribbean, that you thought you were following U.S. policy when you went there?

Mr. **Vind**. Yes. Not only that, but let me also state that Mr. Durbin, who is the author of one of the bills, told me in person, to my face, when I met him some months ago asking him why he was introducing this legislation and informing him as to what it would do to me financially, he said, "Mr. Vind, I am convinced that you are not breaking the law. What I want to do is to change the law."

I said, "Mr. Durbin, that is entirely within your power as an elected official to propose changes, but I hope you recognize that we have followed the law completely to the letter of the law," and he agreed that we had.

Mr. **Frenzel**. You don't disagree with corngrowers and their representatives in trying to stop those who are evading the law?

Mr. **Vind**. I absolutely support that. We have, in fact, joined an ad hoc committee, which is composed of the corngrowers and domestic producers, to solve a number of issues, hopefully the EPA volatility index problem which is facing our industry as well as the ethyl-benzene thing, we are completely in concert on that issue.

Mr. **Frenzel**. Right now you get 30 percent of your raw product from the Caribbean area?

Mr. **Vind**. Yes, we have contracted this year for 30 percent.

Mr. **Frenzel**. Are all those supplying countries certified as beneficiary nations?

Mr. **Vind**. Yes, they are, sir.

Mr. **Frenzel**. You estimate how many years before you could come to 100 percent?

Mr. **Vind**. Approximately 4 years.

Mr. **Frenzel**. How many years?

Mr. **Vind**. Four years.

Let me explain why. First of all, things don't go quickly in Caribbean nations. I think you can appreciate that. It takes a long time to get things done. We have been negotiating with the country of Jamaica since March 1985 to take over an existing sugar mill that they had proposed to close down, one of the largest sugar mills in the country of Jamaica. I met with the Prime Minister on two separate occasions. He just announced 2 days ago that he would not allow us to take over that sugar mill, rather they are going to do it themselves, build their own facility and compete with Tropicana for the U.S. ethanol market. They are going to offer us, instead, a small sugar mill on the other side of the island, which we will take over and use as feedstock for our fermentation plant. We are competing with those countries.

Mr. **Frenzel**. You are competing with other distillers in Jamaica, including the Government of Jamaica?

Mr. **Vind**. Yes, sir, that is correct. The same thing has happened to us in Costa Rica. I think they like our idea and steal it, and away they go. That is competition, and we don't mind it. But, it makes it more difficult.

My point is, it is making it extremely difficult for companies, such as ours, to source feedstocks for our plant if we are going to be competing with the very nations that do provide those feedstocks through government-owned and government-subsidized facilities.

Mr. **Frenzel**. And I suppose that before you can negotiate contracts with countries that will have to, I suppose, plant more sugarcane, you are going to have to be able to convince them that the American Government is not going to lock the door on the market?

Mr. **Vind**. That is part of our problem.

Mr. **Frenzel**. I thank you and your fellow panelists for your help, and I yield the balance of my time.

Chairman **Gibbons**. All right. I hope that the Government of Jamaica won't help, it can put subsidized sugarcane into an ethanol plant and bring it out without getting slapped with some duties here, because I am going to eventually convince Mr. Frenzel or hear that it is a good idea to tighten up on that law. If I don't convince him, I am going to try to run over him anyway. If I don't convince him, that is something that worries me about your operation, not your operation, but other operations.

Your testimony is that you are not using any Brazilian alcohol, you have got a little wine coming in from Spain. It is 80 percent of what you now run through your plant, is that right?

Mr. **Vind**. Yes.

Chairman **Gibbons**. But your aim and objective is to get all Caribbean type of stock running through there.

Mr. **Vind**. Yes, sir.

Chairman **Gibbons**. Did you know when you went there you were going to have to rely on Spain to provide it?

Mr. **Vind**. Yes, sir. That was part of our submittal to the Customs Service. We recognized we would have to start our facility with non-Caribbean feedstocks ultimately sourcing everything from the Caribbean.

Chairman **Gibbons**. How long do you think it will take to get all Caribbean sourced?

Mr. **Vind**. I think 4 years, sir.

Chairman **Gibbons**. All right. Well, thank you very much.

Mr. **Frenzel**. Would you yield a moment?

Chairman **Gibbons**. Sure.

Mr. **Frenzel**. The company whose testimony I put into the record, I think, probably will use some Brazilian supplies. I suspect Mr. Vind has got most of the other stuff around, and I don't believe that the use of Brazilian supplies should damn any particular operation, particularly if their attempt is to follow all our rules.

I also don't object, as you know, to any kind of countervailing efforts that are taken if it is proven that any supplier is subsidizing its product. Thank you.

Chairman GIBBONS. Well, I agree. You know the only reason I pointed out about Brazil is that if there were no Brazilian or Spanish wine, no Spanish wine or no Brazilian alcohol running through his plant, he wouldn't have to worry, he wouldn't need a special permit. He wouldn't need a special ruling. It is just the fact that he has that Spanish grapejuice running through there that gives him trouble.

Mr. VIND. That is correct.

[Mr. Frenzel requested the following be entered in the record:]

STATEMENT OF RICHARD BERRYMAN ON BEHALF OF ALLIED ETHANOL & FUEL CORP., LTD. TO THE HOUSE SUBCOMMITTEE ON TRADE CONCERNING H.R. 1567 AND H.R. 1720

Mr. Chairman and Members of the Committee:

My name is Richard Berryman. I am a member of the law firm of Fried, Frank, Harris, Shriver & Jacobson in Washington, D.C. I appear today in connection with this committee's hearings on H.R. 1567 and H.R. 1720 on behalf of our client Allied Ethanol and Fuel Corp., Ltd., a joint venture company formed to own and operate ethanol facilities in a CBI beneficiary country. Allied has submitted a formal statement. In view of the time limits on oral presentation, I shall not read the statement, but present a brief summary and answer any questions you may have.

In reliance on the Caribbean Basin Economic Recovery Act and on a favorable letter ruling of the United States Customs Service, Allied has expended or committed over $13.0 million to the construction in a CBI beneficiary country of a refining facility for the upgrading, by azeotropic distillation, of beverage grade alcohol to fuel grade alcohol. H.R. 1567 and H.R. 1720 would eliminate CBERA's benefits for imports of this product, with a resulting financial loss to the venture and setback to the people of the Caribbean country concerned. We believe the unavailability of this product in the U.S. market would also be a loss for U.S. ethanol consumers.

Allied Ethanol is a creature of the CBERA. Except for the inducements of, and reliance on, that legislation, the investment of the several millions of dollars in plant and equipment here involved would not have been made. Allied Ethanol is not a company or country trying to utilize a statutory loophole contrary to legislative intent. Its action is not intended and could not possibly result in the type of injury so widely forecast by the proponents of the pending bills. It is a company acting within the statutory mandate of CBERA and accomplishing the goals of that legislation. Opponents of Allied's project have made a strenuous effort to exclude the product of Allied's plant from CBI benefits. To date they have failed. Their initial challenge was to a Customs Service ruling as to the qualification of the product of Allied's plant for CBERA benefits. The allegation was that the local processing of imported feedstock did not substantially transform the resulting product into a new and qualifying product. After full consideration of the opponents' arguments, the Customs Service affirmed its view that the product of Allied's plant would indeed undergo the requisite "substantial transformation."

Having failed in that forum, the opposition seeks now to defeat the project and others similarly situated by legislation that would change the CBERA entitlement criteria ex post facto to deny the promised benefits of CBERA. This, we submit, is unfair. Moreover, it is unjustified. Congress enacted the CBERA only after extensive debate and balancing of views. The resulting law is detailed and complex, reflecting the substantial care with which Congress crafted the legislation. In those cases where, in the balancing of national policies, a superior interest was identified, products were expressly excluded from CBERA benefits. Ethanol was not one of these. It is clearly entitled to CBERA benefits.

Allied and other CBI producers are not the type of foreign ethanol or blend importers who have been described as threatening to flood the U.S. market and depress ethanol prices to the injury of the U.S. farmer. Allied's members include U.S. companies who are in full sympathy with the plight of the U.S. farmer. In its review of the economic bases of the project, Allied determined that its project would have no measurable negative impact on the U.S. farmer, while it would have a measurable affirmative impact, both practical and symbolic, on the CBI program. These conclusions were based on one fact which is ignored by Allied's opponents, namely, that there is such a present and projected U.S. market deficit of ethanol that CBI imports such as Allied's are necessary to maintain a ready supply to domestic users and a reasonable market price. We know of no responsible study which suggests to the contrary, and we urge that there should be no consideration of any changes in the CBI program without a sound economic case therefor being made. In our judgment, the case for the free working of market forces here is clear, while the case for de facto exclusion of Allied's CBI-produced ethanol simply cannot be made.

Thank you for the opportunity to express the views of Allied Ethanol.

STATEMENT OF ALLIED ETHANOL AND FUEL CORP., LTD. TO THE HOUSE SUBCOMMITTEE ON TRADE IN OPPOSITION TO H.R. 1567 AND H.R. 1720

Allied Ethanol and Fuel Corp., Ltd. ("Allied") appreciates the opportunity to present its comments in opposition to H.R. 1567 and H.R. 1720 concerning the exclusion from the Caribbean Basin Economic Recovery Act ("CBERA") of ethyl and alcohol (ethanol), which is distilled in a CBERA beneficiary country. Allied is a joint venture which is made up of Burton M. Joseph of Minneapolis, Minnesota, Turner Investments Ltd., of Baton Rouge, Louisiana, and J. Ray and Nephew, Ltd., of Kingston, Jamaica. In and reliance on CBERA, and on a favorable letter ruling of the United States Customs Service, Allied has committed or expended over $13 million to the construction in a CBERA beneficiary country of a refining facility for the upgrading by azeotropic distillation*/ of beverage grade alcohol to fuel grade alcohol for importation to the United States. The two bills in question would eliminate CBERA's benefits for this product with a resulting financial loss to the venture. It would also constitute a major setback to the CBERA program, and the Caribbean peoples dependent thereon.

Congress should not adopt the proposals contained in H.R. 1567 and H.R. 1720. Fuel grade ethanol distillation facilities constitute precisely the type of capital investment and technical assistance to the Caribbean envisioned by the CBERA. Azeotropic distillation of fuel grade ethanol from alcohol feedstock is a complex process requiring large investment and sophisticated engineering. It is clearly a substantial manufacturing operation of the type required by the CBERA regulations. Azeotropic distillation is not a pass-through operation or a means for foreign ethanol producers to evade U.S. tariffs. The strong opposition to foreign importers and blenders is misplaced when directed also to the industries operating under the CBERA program. In point of fact, Allied and others similarly positioned share the goal of closing loopholes in U.S. tariff laws which may be capable of abuse. CBERA, however, does not provide such a loophole.

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*Azeotropic distillation is the commercial method by which 199.5 proof ethanol is manufactured from 150-190 proof alcohol raw material. To transform 150-190 proof alcohol to 199.5 proof ethanol of fuel grade quality, a chemical entrainer such as benzene must be used to break the bond between water and ethanol (termed an azeotrope) which exists at lower proofs. Simple distillation methods such as boiling can not break this azeotrope. In addition, azeotropic distillation removes harmful chemicals from the alcohol, such as esters and aldelhydes.

The azeotropic distillation facility proposed by Allied and fuel grade ethanol facilities in general, will provide a significant infusion of capital and technical assistance into the Caribbean, and further free trade between the U.S. and the region, in keeping with the purpose of the CBERA. As noted above, some $13 million has been invested and committed by Allied for the first year of this project, in reliance on CBERA incentives. It is anticipated that after completion, the project will infuse another $8-9 million a year into the local economy as payment for goods and services. These facts make clear that azeotropic distillation is not a pass-through operation of the type prohibited by the CBERA. Complex chemical engineering, which clearly substantially transforms the raw material into a new article of commerce, is a far cry from simple blending, chopping or diluting processes. Thus, these facilities will not provide foreign ethanol producers with a means of evading U.S. tariff laws. On the contrary, fuel grade ethanol produced in the Caribbean will be closely monitored by Customs and will comply with U.S. tariff laws in every respect.

This is not an isolated problem. Other substantial American business people, in addition to Allied, have also relied on Customs' interpretation of the CBERA in setting up fuel grade ethanol distillation facilities in the Caribbean. It would be injurious in the extreme for Congress to now reverse itself by excluding ethanol from the CBERA and invalidating these investments at this time. Such a decision would not only injure individual investors, it would undermine CBERA.

At the time Congress originally considered passage of the CBERA, it took into account the fears of U.S. industries that duty-free imports might harm certain sectors of the domestic economy. After careful review of industry and labor positions, Congress chose to exempt certain products such as textiles, from CBERA eligibility. Congress did not choose to exclude ethanol from the CBERA, despite the existence of past federal policies aimed at assisting the domestic ethanol industry. Congress was fully aware of these policies, and of domestic fuel needs, at the time it adopted the CBERA. There is no reason for Congress to reconsider its decision now. It would be a major error to lump participants in the CBERA program in with Brazilian exporters and offshore blenders. Their situation is totally different.

Contrary to their claims, domestic industries will not be harmed by imports of ethanol from the Caribbean. At present, domestic demand for ethanol outstrips domestic production, and with the implementation of the new EPA restrictions on lead in gasoline, the domestic requirement for ethanol could soar from the present 750 million gallons a year to over six billion gallons a year in the next ten years. It is thus clear that there is plenty of room in the U.S. market for both domestic producers and fairly traded imports from the Caribbean.

Congress should not now revisit the decisions it made when it passed the CBERA, as such revision can only undermine the program and send a clear message to our Caribbean friends that the CBERA was merely a gesture, not a real commitment to aiding Caribbean Basin countries. The CBERA will lose its dynamic force if Congress demonstrates its willingness to revise the CBERA every time a domestic special interest opposes entry of a product under the CBERA provisions. No prospective investor will find the CBERA incentives meaningful if there is a fear that benefits once granted could be withdrawn at any time. This is particularly true if a project such as that of Allied Ethanol, which has complied with every statutory and regulatory requirement, and which so directly furthers the purpose of the CBERA, can be derailed by an attack from special interest groups. Congress must not allow this to happen.

Respectfully submitted

BEST COPY AVAILABLE

Chairman **Gibbons**. All right. Let's go to Customs now, and let them talk about this thing. They have been much maligned here. Let's see what they have to say. You have been here. You have heard the testimony. What have you got to say for yourselves? The Government is always in a position of defending themselves for their decisions. Let's hear from Customs first.

You went through an original hearing and appeal of that. Now someone is threatening to take you to court. Why is this a substantial transformation?

STATEMENT OF HARVEY B. FOX, DIRECTOR, CLASSIFICATION AND VALUE DIVISION, U.S. CUSTOMS SERVICE, ACCOMPANIED BY ROGER CRAIN, CHEMIST

Mr. **Fox**. To have a substantial transformation, you have to create a new and different article of commerce, having a new name, character, or use. As Mr. Vind said, a domestic interested party petition was filed on behalf of the National Corn Growers Association, New Energy Co. of Indiana, Ohio Farm Bureau Federation Inc., South Point Ethanol, and Archer Daniels Midland Co. in accordance with 19 U.S.C. 1516 and 19 CFR Part 175. This petition challenged the Customs Service ruling on azeotropic distillation. The petition was filed with the Customs Service on January 29, 1985, and was published in the Federal Register on April 11, 1985. A 60-day period was allowed for all interested parties to submit comments. Over 45 comments were submitted in response to the Federal Register notice. These comments were reviewed very carefully. We issued on November 19, 1985, a five-page decision affirming our ruling of September 12, 1984. To summarize that decision, we held that, one, the absence of water makes 199+ proof ethanol suitable for use in gasohol and that 190 proof ethanol is not suitable for that use, two, 190 and 199+ proof ethanol have different freezing points, boiling points, densities, viscosities, vapor pressures, and flashpoints, three, the price differential between 190 and 199+ proof ethanol reflects industry recognition that it is a new and different product, four, complex equipment and sensitive instruments are used, five, substantial capital investment is necessary, and six, skills requiring training are necessary for workers to operate and monitor the systems.

Chairman **Gibbons**. Now does anyone use 190 proof ethanol in gasohol around here, do you know?

Mr. **Fox**. It can't be used. You can't have water in gasohol.

Chairman **Gibbons**. You can't? My son got some in his, and I just wondered. He apparently got a product that wasn't approved, I guess. They sell it in service stations in Florida occasionally.

Mr. **Fox**. My understanding is that when individuals decide to use gasohol in their service station they must dry out the entire tank, there can't be any water in the tank whatsoever.

Chairman **Gibbons**. That wouldn't stop anybody from selling it in Florida, would it? I am not kidding. My son had a car, he had to throw it away because he thought he was being patriotic in buying some gasohol, and it so screwed up the car, a nice Mercury car that he paid a lot of money for, that the mechanic said "You might as well throw it away, it is never going to run right, you ran that gasohol through there."

I will never put it in mine, and I am sure not going to put it in my boat. They will cancel my warranty on my 275-horsepower motor, and that is quite an investment. I am scared to death of the stuff. Because somebody apparently got burned to death over it, it rotted out the couplings on the hoses, and I am scared of it, frankly.

We got a huge subsidy on it here by exempting it from the gasoline tax and fuel tax. We got a huge tariff on it that slipped through this place in the middle of the night, well by 4 a.m., as I recall, and I don't know what we produced. I think we are producing a bunch of junk, but go ahead. It is that 5 percent water in there that makes it junk, is that it? In other words, we don't sell it in this country, it can't be sold in this country unless it has that 5 percent of water out of it, is that correct?

Mr. Fox. It has to be 199-plus proof to be used in gasohol in this country. The price differential is also about 12 cents a gallon.

Chairman Gibbons. Between the 190 and 199, is that right?

Mr. Fox. It is about 12 cents on a gallon.

Chairman Gibbons. Twelve cents is what part of the total cost? Twelve cents is how much of the total cost? Does it cost 13 cents, or does it cost $1, or what?

Mr. Crain. I think it is about $1.50, Mr. Chairman.

Chairman Gibbons. In other words, a gallon costs about $1.50, and the difference between 190 and 199——

Mr. Crain. It might be slightly over $1. Somewhat less than $1.20 is the last figure I saw.

Chairman Gibbons. Twelve percent we are talking about?

Mr. Crain. Substantially.

Chairman Gibbons. This is substantial transformation.

Mr. Crain. Yes, sir, azeotropic distillation is a substantial transformation.

Mr. Fox. Roger Crain here is a chemist with the U.S. Customs Service. If you would like, he will explain the azeotropic process to you.

Chairman Gibbons. Go right ahead please.

Mr. Crain. Thank you, Mr. Chairman.

As you may know, distillation is used in order to separate two different components with different boiling points. Ordinarily, simple distillation brings that about by vaporizing the component with the lowest boiling point first and then the successively higher——

Chairman Gibbons. Just keep adding heat and it keeps going right up?

Mr. Crain. That is correct.

The temperature of the boiling liquid keeps going up, and the low boilers boil off first.

Chairman Gibbons. Yes.

Mr. Crain. And then at the top of the column typically, after many cycles of vaporization and recondensation, the light boiling materials condense, and they condense in exactly the reverse order as they initially boiled off. The first ones to boil are the last ones to condense. However, that is under ideal conditions.

In the real world, various mixtures form what are called azeotropic mixtures. This means that the vapor that boils off has exactly the same composition as the liquid that is boiling, and it, therefore, becomes impossible to separate an azeotrope from—it becomes impossible to separate the components in an azeotrope by continued distillation. Typically in an azeotropic distillation process, you need to add a third component called an entrainer, and it functions basically as a carrier to take one of the components out of the other. In this case, the entrainer is benzene.

In an azeotropic process for separating the benzene water ethanol mixture, the crucial factor is the fact that the azeotrope that distills off is of two phases. The two phases can then be separated. The two phases are benzene saturated with water and water saturated with benzene. That azeotrope is then separated in a decanter—in a decanting tank, and the benzene is recycled and the water is eventually discarded.

The ethanol, contrary to a normal distillation where the product of interest comes out the top, the ethanol in this case slowly percolates down through the column until it comes out essentially water-free at the bottom.

Chairman GIBBONS. That adds about 12 percent to the cost?

Mr. CRAIN. Approximately, yes, sir.

Chairman GIBBONS. In your opinion, how many dollars do these people have in this plant?

Mr. CRAIN. I really have no idea, Mr. Chairman. Although I would imagine that it is fairly—it is indeed complex equipment. There is a variety of mechanical equipment, such as pumps and compressors and preheaters and that sort of thing, and there is quite a bit of control apparatus that is involved too, temperature and pressure meters and flow meters and so on. It is not a simple operation at all. It requires trained staff.

Chairman GIBBONS. On a matter of complexity, the rest of the alcohol making process, is it extremely complex? Is it relatively complex?

Mr. CRAIN. I would say, considering the whole alcohol production process, it is probably one of the most complex parts of that entire operation. Of course, the relative cost is going to go down the more parts of the operation that you consider. But, for example, the fermentation process is relatively straightforward. People have been making alcoholic beverages for quite a long time. It is only recently, of course, that the technology for azeotropic distillation was discovered. By recently, I mean within the past several hundred years or so.

And, of course, the technology for molecular sieves, as was mentioned earlier, is more recent than that.

Chairman GIBBONS. Now, was there anything unusual about this importer or processor coming in and asking you all for a special ruling?

Mr. FOX. Mr. Chairman, under 19 CFR, part 177, of our regulations, anybody can write in and obtain a binding ruling from the Customs Service. If an individual wants to know what his or her duty liability is going to be prior to making an importation, he or she can write in and request a ruling from us. Here at headquarters, we issue perhaps 2,300 rulings per year, and our New York office issues over 3,000 rulings per year. There is nothing unusual at all about this importer requesting a ruling.

Chairman GIBBONS. How long was this application considered the first time? When was it filed, and when was a ruling made?

Mr. FOX. I would have to get that information for you. The first ruling we issued was in September 1984. But when they made their submission to us, I would have to get that information.

Chairman GIBBONS. They made their submission in 1984, and you all ruled when?

Mr. FOX. We ruled in September 1984. When they made their submission to us for ruling, I don't have that information with me, but I will get it for you.

Chairman GIBBONS. Would you please, and put it in the record at this point.

[The information follows:]

DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE
WASHINGTON, D.C. 20229

18 FEB 1986

REFER TO
CO:R:V

The Honorable
Sam M. Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

During the hearing held on Friday, February 7, 1986, concerning proposed legislation on ethanol, you requested that we furnish you with certain correspondence pertaining to a Customs ruling on the azeotropic distillation of ethanol in a beneficiary country of the Caribbean Basin Economic Recovery Act (CBERA).

In accordance with your request, we are providing you with the following:

Exhibit A - Ruling request and supplemental submissions from the law firm of Collier, Shannon, Rill and Scott dated July 19, July 23 and August 13, 1984. Certain information was deleted from the July 19 and 23 letters pursuant to a request for confidential treatment.

Exhibit B - Ruling letter to Michele A. Giusiana, Esq., from the Director, Classification and Value Division, dated September 12, 1984.

Exhibit C - Petition by Domestic Interested Parties filed on behalf of the National Corn Growers Association, New Energy Company of Indiana, Ohio Farm Bureau Federation, Inc., South Point Ethanol and Archer Daniels Midland Company pursuant to 19 U.S.C. 1516 and 19 CFR Part 175. The petition was filed on January 29, 1985.

Exhibit D - Receipt of Domestic Interested Party Petition Concerning Tariff Classification of Certain Fuel Grade Ethanol. Published in the Federal Register on April 11, 1985.

Exhibit E - Customs Service response to the Petition by Domestic Interested Parties dated November 19, 1985.

Exhibit F - Petitioners' Desire to Contest Decision Denying Domestic Interested Party Petition Requesting Reclassification of Certain Fuel Grade Ethanol. Published in the Federal Register on January 22, 1986.

If we can provide you with any additional information, please do not hesitate to contact us.

Sincerely,

Harvey B. Fox
Director, Classification
and Value Division

Enclosures

EXHIBIT A

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Jeanne M. Forch
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Christopher J. MacAvoy
Donald J. Patterson, Jr.
Randall J. Bramer
Kevin F. Hartley

July 19, 1984

Mr. Harvey B. Fox, Director
Office of Regulations and Rulings
Classification and Value Division
Customs Headquarters
1301 Constitution Avenue, N.W.
Washington, D.C. 20229

Re: Private Ruling Request

Dear Mr. Fox:

The Caribbean Basin Economic Recovery Act ("CBERA") accords duty-free treatment to all eligible articles imported directly into the customs territory of the United States from designated beneficiary countries. See 19 U.S.C. § 2701 et seq. (1983). Pursuant to 19 C.F.R. Part 177 (1984), our client, a U.S. corporation, hereby requests a private ruling letter from the U.S. Customs Service regarding the eligibility for duty-free entry under CBERA of ethanol
which would originate,
be processed in a beneficiary country,
, from beverage grade ethanol to
motor fuel grade ethanol and be imported
Specifically, the company requests verification that the processing of beverage ethanol into motor fuel ethanol constitutes substantial transformation into a new or different article of commerce under CBERA. In addition, the company seeks verification that it is correctly calculating CBERA's 35 percent value content requirement for articles produced in a beneficiary country.

Such contracts, however, are contingent upon a favorable ruling from the U.S. Customs Service. For this reason, the company requests expedited review of its request.

1. Description of Transaction.

The company will engage in a series of transactions which will all be basically as follows:

The company will import to a beneficiary country,
beverage ethanol
from beneficiary countries
and from non-beneficiary countries, *See* Exec. Order 5133 (Nov. 30, 1983) (Annex), 48 Fed. Reg. 54,454 (Dec. 5, 1983). The proof of the beverage ethanol will range from 150 to 180 proof, or 25 to 10 percent water, respectively. Because of its high water content, the "wet" ethanol is not usable as motor fuel.

to process the wet ethanol to "dry" or "anhydrous" ethanol. The wet ethanol will be transformed to anhydrous ethanol through a two-stage distillation process. The first stage will distill the ethanol to 190+ proof, less than five percent water, using a standard distillation column. At this point, the remaining water will have formed an azeotrope with the ethanol, which prevents separation of water and ethanol through a standard distillation column. The second stage will process the ethanol through an azeotropic distillation column which will separate the ethanol-water azeotrope and distill the ethanol to 199.5 proof, 0.25 percent water. Both stages of the distillation process are described in detail in Attachment 1.

In addition, after distillation, our client is considering denaturing the motor fuel grade ethanol at this point by adding gasoline in accordance with U.S. Bureau of Alcohol, Tobacco and Firearms regulations. 27 C.F.R. § 212.3 (1983). The gasoline would be produced and added to the distilled ethanol in a beneficiary country.

To conclude the transaction, our client will export the motor fuel grade ethanol directly to the United Sates

2. The Motor Fuel Grade Ethanol Qualifies For Duty-Free Treatment Under CBERA.

To qualify for duty-free treatment under CBERA, motor fuel grade ethanol must be imported directly into the United States from a beneficiary country and be an "eligible article," *i.e.* the motor fuel grade ethanol cannot be an article excluded from CBERA and must meet a country of origin requirement. *See* 19 U.S.C. § 2701 *et seq.*; 19 C.F.R. Part 10 (1984). The country of origin requirement has two elements: (1) the article must be either "wholly the growth, product or manufacture of a beneficiary country or must be a new or different article of commerce which has been grown, produced or manufactured in the beneficiary country;" and (2) meet a 35 percent content value requirement. See 19 U.S.C. § 2703(a); 19 C.F.R. § 10.195(a). In addition, to qualify as a new or different article of commerce, the article must have been "substantially transformed" in the beneficiary country. This "substantial transformation" must consist of more than "simple combining or packaging operations" or "mere dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article." See 19 U.S.C. § 2703(a)(2); 19 C.F.R. § 10.195(a) (1984).

See Exec. Order 5133, 48 Fed. Reg. 54,454 (1983). Also, motor fuel grade ethanol is not excluded from CBERA duty-free treatment. See 19 U.S.C. § 2703(b); 19 C.F.R. § 10.191(b)(2). As discussed in detail below, the motor fuel grade ethanol also meets the country of origin requirement.

a. The Motor Fuel Grade Ethanol Is A Substantially Transformed, New Or Different Article of Commerce.

Motor fuel ethanol processed from beverage ethanol imported from another beneficiary country meets the "wholly the growth, product or manufacture" test of the CBERA's country of origin requirement. Motor fuel ethanol processed from beverage ethanol imported from a non-beneficiary country meets the "new or different article of commerce" test and, therefore, meets the first element of CBERA's country of origin requirement.

Motor fuel grade ethanol is a new and different article of commerce from beverage grade ethanol. The two grades of ethanol have different end uses: beverage ethanol cannot be used as motor fuel because of its high water content and motor fuel ethanol is not potable because of the denaturant required under U.S. law.

The two also have different chemical compositions.

(the beverage ethanol) have a peculiar color and contain relatively high amounts of specific aldehydes and esters, which give the beverage their identifying flavors. The coloration and flavorings are actually impurities from the grain and fermentation process and are enhanced by aging. As a result of distillation in the beneficiary country, the motor fuel ethanol will have a water white color and contain a relatively low mixture of higher alcohols, aldehydes and esters. The distillation will, in effect, purify the final product to such a degree as to make it a significantly different product from the feed material (the beverage ethanol), unsuitable as a beverage and suitable only for fuel use.

The difference between the two types of ethanol is the result of the complex and highly technical distillation process involved. See Attachment 1. As the attached description clearly demonstrates, the entire distillation process (both stages) is complex and obviously consists of much more than "simple combining or packaging operations" or "mere dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article." See 19 U.S.C. § 2703(a)(2); 19 C.F.R. § 10.195(a) (1984).

Finally, beverage ethanol and motor fuel ethanol are treated differently under U.S. law. The Tariff Schedules of the United States ("TSUS") classify the two products in separate item numbers (169.01 and 427.88, respectively) located in different parts of the TSUS. Also, under U.S. Bureau of Alcohol, Tobacco and Firearms regulations, ethanol of less than 185 proof (beverage grade alcohol) may not be imported for use as motor fuel. See 27 C.F.R. § 251.171 (1983). Moreover, the Internal Revenue Service provides a tax exemption for ethanol of not less than 190 proof. 26 U.S.C. § 4081(c)(3) (1982). Thus, our client's motor fuel grade ethanol is clearly a new or different article of commerce.

b. The Motor Fuel Ethanol Will Meet The 35 Percent Value Content Requirement.

the company is aware of the types of costs that it will be including in its calculation and seeks verification that the costs it intends to include are appropriate. The costs of processing incurred in the CBERA beneficiary country include: (1) the direct costs of processing beverage ethanol to motor fuel ethanol, including fuel costs, labor costs (including fringe benefits and job training), equipment depreciation and amortization, and product shrinkage; (2) the delivered cost of any beverage ethanol wholly-grown, produced or manufactured in a beneficiary country; and (3) the delivered cost of the gasoline imported from a beneficiary country and used as a denaturant. The company, of course, will maintain records of these costs.

4. Claim of Confidentiality.

The information contained in this letter -- the intended transaction, sources of ethanol and cost data -- are confidential, and disclosure may cause substantial harm to our client's competitive position. For that reason, the company requests confidential treatment of this private ruling request in accordance with 19 C.F.R. § 177.2(b)(7).

5. Knowledge Of Similar Transactions.

We are uncertain whether any similar transaction has ever been considered or is currently being considered by the U.S. Customs Service, but believe that the U.S. Customs Service may have issued a private letter ruling on a similar question which recognized that distillation from beverage ethanol to motor fuel ethanol constitutes substantial transformation under the General System of Preferences. See Private Letter Ruling CLA-2CO:R:CV:VS 071693TL (Jan. 3, 1984). We are unaware of any litigation on this matter.

CONCLUSION

Our client's processing of beverage grade ethanol to motor fuel grade ethanol in a beneficiary country, constitutes substantial transformation to a new or different article of commerce under CBERA. The U.S. Customs Service should issue a private ruling letter accordingly.

If you have any questions or would like to meet with us to discuss this request, please let us know. Thank you for your prompt attention to this matter.

Sincerely,

M. C. Giusiana

R. Sarah Compton
Michele A. Giusiana

Attachments

RSC/tdh

Attachment 1

DISTILLATION PROCESS

The distillation process which our client will use to transform the wet ethanol to motor fuel grade anhydrous ethanol will be conducted in two stages.

STAGE ONE

In simplified terms, stage one of the distillation process will consist of a vertical cylindrical tower which contains trays or packing, a heat exchanger to condense the overhead vapors, a reflux or accumulator drum to provide an inventory of liquid, a pump to move the condensed liquid back into the tower as reflux or as a final product (ethanol) storage tank, a feed line, a bottoms product line and a heat exchanger or reboiler to generate vapors. See Attachment 2, Figures 1 and 3.

The feed (beverage ethanol) enters the tower on the fourth tray from the top of the tower. See Attachment 2. It then flows downward across trays 4, 5, 6 and 7 1/ in a zig-zag fashion until it reaches the bottom of the tower. This liquid is mostly water, but does contain a small percentage of ethanol. Some of the liquid in the bottom of the tower is continuously removed as bottoms product. The remainder of the liquid flows to the bottom of the reboiler. The reboiler is a heat exchanger with steam condensing on the inside surface of many tubes in parallel. Heat from the steam is transferred through the walls of the tubes to the liquid flowing from the bottom of the tower. Since the liquid in the bottom of the tower is already at its boiling point, the additional heat from the condensing steam causes some of the liquid to vaporize. The vapors of ethanol and water leave the top of the reboiler and enter the tower below the bottom perforated (sieve) tray. These vapors flow upward through the holes in the sieve trays and come out the top of the tower.

The vapors leaving the tower are completely condensed back to a liquid in the condensor. The condensor is a heat exchanger which has cold water flowing through the inside of many tubes. Heat flows from the alcohol vapors causing them to condense to liquid. This heat flows through the metal tube walls and heats the cooling water from approximately 80 degrees Fahrenheit to 110 degrees Fahrenheit.

1/ The tray numbers refer to the figure in Attachment 1. The description and attached figure of the distillation process have been simplified.

The condensed liquid accumulates in a vertical cylindrical drum (the reflux tank). The liquid flows continuously from the reflux drum to a pump. Part of the liquid discharged from the pump is the overhead alcohol product which is pumped to a final storage tank, and part is pumped back to the top tray of the tower as external reflux.

Liquids flow down the tower due to gravity. All of the liquid in the tower is at its boiling temperature or bubble point. Also, all of the vapor in the tower is at its condensing temperature or dew point. Since the liquid at the top of the tower is almost pure ethanol, its temperature will be approximately 173 degrees Fahrenheit (78.3 degrees Celsius), and since the liquid at the bottom of the tower is almost pure boiling water, its temperature will be 212 degrees Fahrenheit (100 degrees Celsius). The liquid on the other trays in the tower will be at intermediate temperatures between 78.3 degrees Celsius and 100 degrees Celsius. Because of the composition trend toward percentages of ethanol in the liquid and vapor phases as the liquid and vapor moves upward in the tower, there is a gradual temperature change from the high temperature at the bottom to the lower temperature at the top.

Control of the process is achieved by measuring temperature, pressure, flow rate and liquid level and by comparing this measurement to an established "set point." See Attachment 2, Figure 2.

1. two 4 ft. diameter x 40 ft. tall distillation columns, with 32 and 68 sieve trays, respectively, spaced at 20", with 5/16" holes spaced at 1";
2. a 250 hp. cleaver Brooks Boiler with an input of 10,451,060 BTU/hr.;
3. approximately 325,000 gallons of on-site storage tank; and
4. compressors to provide air for pneumatic controls.

STAGE TWO

"wet" alcohol to anhydrous ethanol 200 proof by the addition of columns for azeotropic distillation. These columns are necessary to distill the beverage ethanol to motor fuel grade ethanol. The capitol investment for this equipment will be approximately (U.S.).

After the first stage of distillation, a small percentage of water (approximately 3 percent) and ethyl alcohol will form a constant boiling point liquid. This liquid is referred to as an azeotrope and has a characteristic boiling point so close to that of pure ethanol as to render traditional distillation techniques useless. The consideration of a mixture of water and alcohol is best exemplified in Attachment 3, Figure 1, "The Vapor Curve KLMNP," which gives the composition of the vapor as a function of the temperature T, and the liquid curve KRMSP which gives the composition of the liquid as a function of temperature. These two curves have a common point M, where the curves are tangent. Because of the special properties associated with systems in this state, the point M is called an azeotropic point. In an azeotropic system, one phase may be transformed to the other at constant temperature, pressure and composition without affecting the equilibrium state. In order to "break" the alcohol-water azeotrope (a binary or two component system), a third agent, known as a separating or entrainment agent is added to the column so as to favorably alter the relative volatilities of the feed components. This forms a different azeotrope with one of the feed components and then this "tertiary" azeotrope may be removed as a bottom or top product.

as the entrainment agent. The selection of an entrainment agent is determined by its ability to form an azeotrope which may be easily recovered from the binary azeotrope, thus requiring a particular volatility.

A representative process diagram of azeotropic distillation is illustrated in Attachment 3, Figure 2, "The Dehydration Process." This illustration, however, is somewhat incomplete in that it illustrates only a two-column system. Some entrainers require three or four columns in the process to gain maximum effect and still maintain an economical advantage.

As shown in Attachment 3, Figure 2, the hydrous alcohol vapor is fed into the dehydration column, DH, through line L-5. The reboiler, R, for the dehydration column, is used to supply heat to the combined solution by means of an internal coil, so that the process requires redistilling the azeotrope solution which by combination of components now has a much lower minimum boiling point.

The upper stream leaving the dehydration column through line, L-2, consists of water and a small amount of alcohol. The larger portion of the internal liquid, devoid of water, leaves the dehydration column, through the bottom stream by means of pump, P-1, as a hot liquid. The bottom stream liquid is now 99 percent plus anhydrous alcohol. This is accomplished due to the combined characteristics of vaporization of water and alcohol, which has been changed from that of alcohol and water by adding the entrainment agent. The bottom stream is cooled to approximately 100 degrees Fahrenheit by means of the heat exchanger, HX, and pumped to the storage tank, T, as the finished product, anhydrous alcohol.

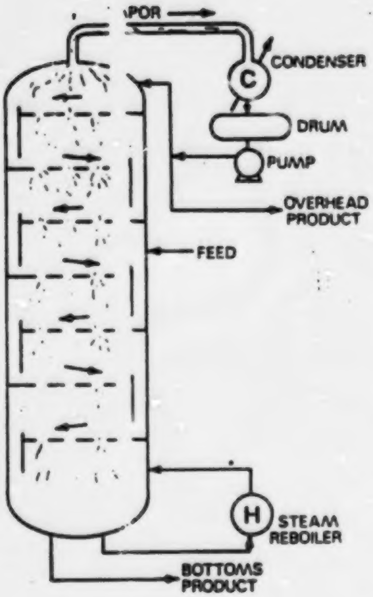
The mixture of alcohol, water and , a ternary minimum boiling azeotrope, leaves the dehydration column through the top stream, L-2, at approximately 150 degrees Fahrenheit, as a vapor. It is passed on to the condenser, CD, and then further reduced in temperature passing through cooler, C, which takes the temperature down to approximately 70 degrees Fahrenheit, liquid, when it enters the decanter, DC.

In the decanter, DC, sufficient volume is designed into the vessel to permit the liquid to assume an almost static condition and thus, natural separation takes place with the larger amount of liquid layering on top with the smaller amount of water-rich liquid on the bottom. Any pressure that may be present does not affect this separation.

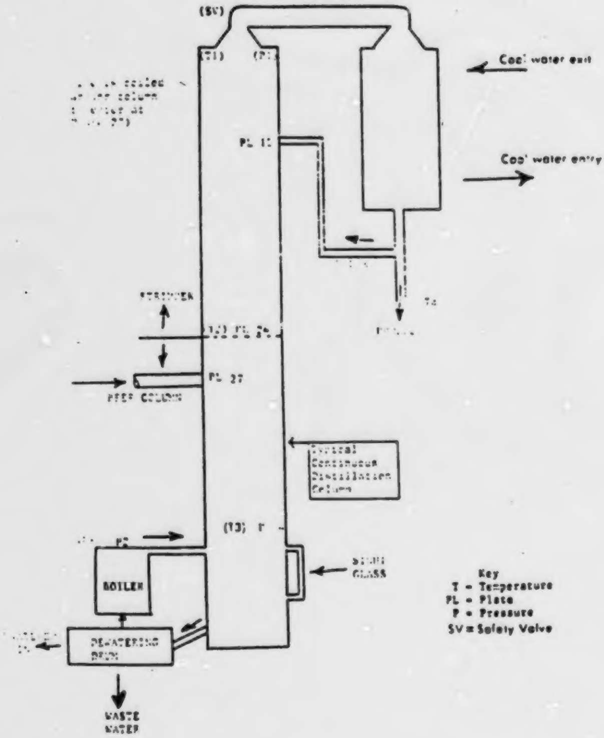
The liquid is recycled back to the dehydration column, DH, through pump, P-2. Make-up is added at this point to replace any that is lost in the water-rich bottom liquid, and is sent to the stripping column. The water-rich liquid is passed on to the hydrocarbon stripping column, S, by means of the reboiler, Rs. The remaining in the liquid plus the remaining alcohol is vaporized and is removed through the top stream, L-3, leaving an almost pure aqueous solution as a liquid in the bottom of the column, S. Pump, P-4, removes this accumulated water under volume control and sends it on to the wastewater treatment section of the facilities. It is important to maintain equilibrium in lines, L-2 and L-3. Much of this total process is conducted at atmospheric pressure.

The entire dehydration process must be carefully balanced in design to minimize cost capitalization, to assure complete automation and control, and to minimize fuel consumption. One may expect to consume from additional BTUs of fuel per gallon of anhydrous alcohol to remove this last portion of water content from the water-ethanol azeotrope. This amount of BTUs is in addition to the amount used in the distillation process prior to azeotropic distillation. Energy consumption will vary with the entrainment agent selected.

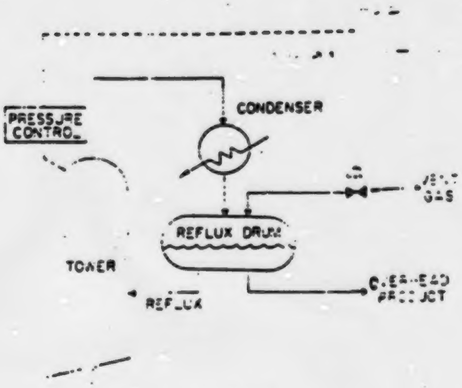
The entire dehydration process is not a "turn key operation but must be carefully monitored around the clock. As a result, our client will be providing jobs to at least people in the beneficiary country.


VAPOR
CONDENSER
C
DRUM
PUMP
OVERHEAD PRODUCT
FEED
H
STEAM REBOILER
BOTTOMS PRODUCT

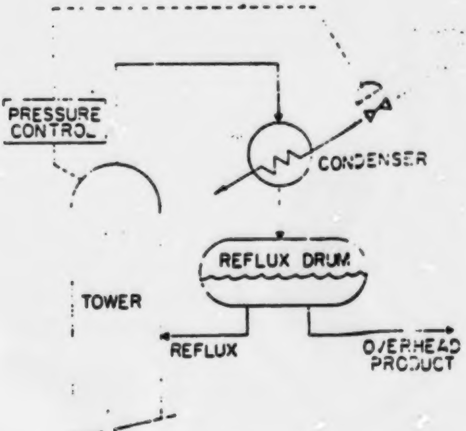
Attachment 2, Figure 2


(SV)
(T1)
(P1)
Cool water exit
PL 11
Cool water entry
STRIPPER
PL 27
FEED COLUMN
Typical Continuous Distillation Column
(T3)
BOILER
SIGHT GLASS
DEWATERING DRUM
WASTE WATER
Key
T - Temperature
PL - Plate
P - Pressure
SV = Safety Valve

Attachment 2, Figure 3


PRESSURE CONTROL
CONDENSER
VENT GAS
REFLUX DRUM
TOWER
REFLUX
OVERHEAD PRODUCT

Inert gas pressure control.


PRESSURE CONTROL
CONDENSER
REFLUX DRUM
TOWER
REFLUX
OVERHEAD PRODUCT

Cooling water pressure control.

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July 23, 1984

~~CONFIDENTIAL~~

BY HAND

Irving W. Smith, Jr., Esquire
Chief, Value and Special
Classification Branch
Customs Headquarters
1301 Constitution Avenue, N.W.
Washington, D.C. 20229

Re: Private Letter Ruling Request of July 9, 1984

Dear Mr. Smith:

As you discussed with Sarah Compton on Friday, July 20, 1984, we are supplementing our private letter ruling request regarding the eligibility for duty-free treatment under the Caribbean Basin Economic Recovery Act ("CBERA") of motor grade ethanol imported into the United States after processing from beverage ethanol in a beneficiary country.

The feedstock materials used to make the motor fuel
will be nonpotable
which is "off-specifications" for reasons such as excessive aldehyde content or other contamination. The
consist of the lower proof materials which remain after distillation, including the
may be used: (1) nonpotable
and
and (2) distilled wine of 190 proof.
Our client will distill the
in the beneficiary country.

The costs considered in the 35 percent value content computation will include the direct costs of processing the beverage ethanol to motor fuel ethanol. The direct costs of processing include

We acknowledge that the cost of distilled feedstocks from non-beneficiary countries cannot be included in computing the 35 percent value content. However, because, as you pointed out,
to motor fuel grade ethanol actually entails

will be included. Finally, the delivered cost of any beverage ethanol or gasoline used as a denaturant which was a product of a beneficiary country will be included. Our client does not intend to use any gasoline which is not a product of a beneficiary country.

If you have any further questions, please do not hesitate to call. As you indicated on the telephone, we look forward to your response within the next 30 days. Thank you again for your assistance on this matter.

Sincerely,

M Giusiana

R. Sarah Compton
Michele A. Giusiana

RSC/tdh

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August 13, 1984

BY HAND

Mr. Harold Singer
Office of Regulations and Rulings
Classification and Value Division
Customs Headquarters
1301 Constitution Avenue, N.W.
Washington, D.C. 20229

Re: July 19, 1984 Request for CBERA Private Ruling Letter

Dear Harold:

This letter is to confirm in writing our telephone conversation of August 8, 1984. In the initial request for a private ruling letter on the eligibility for duty-free treatment under the Caribbean Basin Economic Recovery Act ("CBERA") of beverage ethanol distilled to motor fuel grade ethanol, we identified the feedstock beverage ethanol as having a proof of 150 to 180 (25 to 10 percent water). We have since learned that our client's feedstock ethanol may have an alcohol content of up to 190 proof (five percent water); we wish to amend our request accordingly.

As discussed, 190 proof alcohol is not suitable for use as motor fuel because of its five percent water content. Such ethanol still must undergo azeotropic distillation to 199.5+ proof (less than .25 water) prior to use as motor fuel. In addition, the 190 proof ethanol contemplated as feedstock by our client would not have undergone any azeotropic distillation prior to importation to a designated beneficiary country, but would be the result of only a standard distillation process.

[illegible] [illegible]
August 13, 1984
Page Two

The higher alcohol content of some of the feedstock ethanol should have no effect on the eligiblity for duty-free treatment under CBERA of the motor grade ethanol imported into the United States. Please call us if you have any questions. We appreciate your prompt consideration of our letter request.

Sincerely,

R. Sarah Compton

R. Sarah Compton
Michele A. Giusiana

RSC/tdh

EXHIBIT B

12 SEP 1984

CLA-2 CO:R:CV:V
553209 HS

Michele A. Giusiana, Esq.
Collier, Shannon, Rill & Scott
1055 Thomas Jefferson Street, NW.
Washington, D.C. 20007

Dear Ms. Giusiana:

This is in response to your letters of July 19, July 23, and August 13, 1984, concerning the eligibility for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA) of fuel grade ethanol (also known as ethyl alcohol). You request a ruling that the motor fuel grade ethanol has been substantially transformed in a beneficiary country and seek verification that the costs that your client intends to include in the calculation of the 35 percent value content requirement are appropriate.

Your client will import into a beneficiary country beverage ethanol produced in beneficiary countries and non-beneficiary countries. The proof of the beverage ethanol will range from 150 to 190. Because of its high water content, the beverage ethanol is not usable as motor fuel.

Your client plans to have a distillery located in a beneficiary country process the beverage ethanol to anhydrous ethanol through a two-stage distillation process. The first stage of the process will distill the ethanol to 190+ proof, less than 5 percent water, using a standard distillation column. The second stage will process the ethanol through an aziotropic distillation column which will separate the ethanol-water aziotrope and distill the ethanol to 199.5 proof, 0.25 percent water.

In addition, after distillation, your client is considering denaturing the motor fuel grade ethanol by adding gasoline. The gasoline will be produced and added to the distilled ethanol in a beneficiary country. The motor fuel grade ethanol will then be exported directly to the United States.

First, we will address whether the motor fuel ethanol has been substantially transformed in a beneficiary country. An article is substantially transformed for tariff and related purposes when, as a result of a substantial manufacturing or processing operation, a new or different article of commerce emerges having a name, character or use which is distinct from the article or material from which it was so transformed.

The original beverage grade ethanol and the produced motor fuel ethanol have different end uses. Beverage ethanol cannot be used as motor fuel because of its high water content, and it is not economically feasible to use motor fuel ethanol for beverage use. Within the trade, motor fuel ethanol is consid[illegible]rent article of commerce which is significantly more valuabl[illegible]thanol. Accordingly, as the motor fuel grade ethanol is a ne[illegible]rticle of commerce from the beverage grade ethanol, and is [illegible] a substantial manufacturing process, it is our view that the processing of the beverage grade ethanol into motor fuel ethanol involves a substantial transformation.

Regarding the 35 percent value-content requirement, duty-free treatment of the goods imported into the United States applies only if the sum of the cost or value of the materials produced in a beneficiary country or countries plus the direct costs of processing operations performed in such country or countries is not less than 35 percent of the appraised value of such article. To be included in the 35 percent, a constituent material of the eligible article which is not wholly the growth, product or manufacture of the beneficiary country must have undergone a substantial transformation in the beneficiary country. The material resulting from that substantial transformation must then be used in the production or manufacture of a new or different article, i.e., the article imported into the United States.

In this case, for the 190+ proof beverage grade ethanol to be considered a constituent element of the eligible article, motor fuel ethanol, it must have undergone a substantial transformation in a beneficiary country. It is our view that transforming 150-190 proof beverage grade ethanol to 190+ proof beverage grade ethanol through a simple distillation process is not a substantial enough operation to make the 190+ proof beverage grade ethanol a substantially transformed constituent material. Accordingly, the cost of the 150-190 proof beverage grade ethanol which was not produced in a beneficiary country may not be included in the computation of the 35 percent value-content requirement.

If not included in the manufacturer's actual cost for the materials, the cost of transporting the beverage ethanol that originates from beneficiary countries to the distillery as well as the cost of transporting to the distillery any gasoline that is used as a denaturant and that is produced in a beneficiary country may be included in the computation of the 35 percent value-added requirement. Further, the cost or value of the gasoline itself produced in a beneficiary country and used as a denaturant may also be included. If there is segregation of the beverage ethanol that originates in non-beneficiary countries and that which originates in beneficiary countries, the actual cost of any [illegible] beverage ethanol from beneficiary countries in terms of produc[illegible] may also be included.

O[illegible] may be included in the computation of the 35 percent value [illegible] direct costs of processing the 150-190 proof beverage ethanol to motor fuel ethanol, including fuel costs, labor costs (including fringe benefits and on-the-job training) and equipment depreciation and amortization which are allocable to the specific merchandise.

Sincerely,
(Signed) J. T. Rouh

4cc: AD, NY Seaport
1cc: Harvey Fox
CO:R:CV:V:[illegible]:8/15/84:fnl:8/15:8/20

For Harvey B. Fox
Director, Classification
and Value Division

	(1) INITIATOR	(2) REVIEWER	(3) REVIEWER	(4) REVIEWER	(5) REVIEWER	(6) REVIEWER	(7) REVIEWER
SURNAME							
CODE AND DATE	CO:R:CV:V 9-12-84	R:CV:V 9/12					
SURNAME	Dennis	S. Smith					

DEPARTMENT OF THE TREASURY · U.S. CUSTOMS SERVICE   CORRESPONDENCE APPROVAL AND CLEARANCE   Form 180 (11-19-73)

U.S. GPO:1983-4[illegible]

EXHIBIT C

UNITED STATES DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICE

Petition by the National Corn Growers Association, New Energy Company of Indiana, Ohio Farm Bureau Federation, Inc., South Point Ethanol, and Archer Daniels Midland Company Regarding Importation of Certain Fuel Grade Ethanol

---

WILLIAMS & CONNOLLY

Aubrey M. Daniel, III
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Attorneys for Petitioners

ORIGINAL

UNITED STATES DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICE

Petition by the National Corn Growers
Association, New Energy Company of Indiana,
Ohio Farm Bureau Federation, Inc., South
Point Ethanol, and Archer Daniels Midland Company
Regarding Importation of Certain Fuel Grade Ethanol

The following is a petition by the National Corn Growers Association, New Energy Company of Indiana, Ohio Farm Bureau Federation, Inc., South Point Ethanol, and Archer Daniels Midland Company filed pursuant to 19 U.S.C. 1516 and 19 C.F.R. Part 175 with respect to rulings of the Customs Service concerning the eligibility of certain fuel grade ethanol for duty-free entry under the Caribbean Basin Economic Recovery Act ("CBERA"), 19 U.S.C. 2701, and the Generalized System of Preferences ("GSP"), 19 U.S.C. 2461. The product at issue, ethyl alcohol imported for use with gasoline as a fuel, is classified under item 901.50 of the Tariff Schedules. Petitioners are interested domestic parties. See 19 C.F.R. 175.3.

National Corn Growers Association ("NCGA"), 1000 Executive Parkway, Suite 224, St. Louis, Missouri 63141. NCGA is a nonprofit nonpartisan organization the purpose of which is to enhance and expand the use, marketing, and efficient production of American corn. NCGA's membership consists of approximately 17,000 farmers engaged in the domestic production of corn in all

48 states of the continental United States. The principal agricultural commodity from which domestic fuel ethanol is produced is corn. In addition, NCGA membership includes 19 supporting members from related sectors of the corn industry, including ethyl alcohol manufacturers. Thus, NCGA represents a broad cross section of the United States agricultural industry involved in corn production and the production of ethyl alcohol and is vitally interested in the subject matter of this petition.

New Energy Company of Indiana, 320 West Calvert Street, South Bend, Indiana 46680. Founded in 1980, the New Energy Company of Indiana is a public limited partnership which in August 1984 opened a fuel ethanol facility in South Bend, Indiana. This facility, costing $186 million, has been financed in part by a $141 million loan, ninety percent of which is guaranteed by the United States Department of Energy. This loan guarantee is believed to be the largest award in the federal alcohol fuels program.

Ohio Farm Bureau Federation, Inc., Box 479, 35 East Chestnut Street, Columbus Ohio 43216. The Ohio Farm Bureau is a membership organization of approximately 94,000 farm families in the State of Ohio. The Ohio Farm Bureau has two wholly owned subsidiary corporations that own or have a significant interest in ethanol producing facilities: the Ohio Farm Bureau Development Corp., which operates a small ethanol producing plant in Mt. Sterling, Ohio, and the Ohio Farm Bureau Synfuels Corp., which is one of four partners in South Point Ethanol (see below).

South Point Ethanol, P.O. Box 1004, South Point, Ohio 45680. South Point Ethanol is an Ohio general partnership which owns and operates a substantial fuel ethanol plant in South Point, Ohio.

Archer Daniels Midland Company ("ADM"), 4666 Fairies Parkway, Decatur, Illinois 62526. ADM is a corporation engaged principally in the business of processing and merchandising agricultural commodities. ADM currently operates three ethyl alcohol plants and is the largest producer of fuel ethanol in the United States.

INTRODUCTION

To grasp the importance of the matters raised in this petition, an understanding of the current status of the domestic fuel ethanol producing industry is crucial. That industry has been nurtured since 1978 by a variety of federal economic incentive programs, including the imposition of duty on the importation of foreign fuel ethanol, designed to promote important national interests. In a speech in August 1984 in Decatur, Illinois, President Reagan stated:

> [the] pioneer work in ethanol . . . . increases demand for farm products, creates new jobs, and leads to greater energy security for our country . . . .
>
> When we took office in 1981, only 75 million gallons of ethanol fuel were being produced. This year, more than 450 million gallons will be produced requiring more than 180 million bushels of corn. . . .

> We know that the Federal Government has an important role to play as a partner to the farm community. I think the gist of that role is to help farmers do what they can't always do on their own -- seek out new markets, counter unfair trading practices of our trading partners, promote research, provide a measure of protection from erratic weather and natural disasters, and create a proper environment for supply and demand forces to allocate resources efficiently.

The domestic fuel ethanol industry is threatened today by practices of foreign producers designed to circumvent the 60-cent per gallon duty that is imposed by statute on the importation of fuel ethanol. TSUS 901.50. If these practices are allowed to persist, the potential adverse consequences, both to the domestic industry and the public generally, are enormous.

1. Ethanol, also known as ethyl alcohol, is an alcohol product of fermentation that is derived from corn and other agricultural products and that can be used in alcohol beverages and for a variety of industrial uses. Most importantly in the context of this matter, ethanol can be mixed with gasoline -- usually in a gasoline-to-ethanol ratio of 9 to 1 -- and used as a motor fuel. Although ethanol has been recognized as a viable fuel source since the first days of the automobile, modern marketing of ethanol as a motor fuel was not seriously considered until the 1970s. Beginning with the Arab oil embargo in 1973 and the dramatic price escalation for foreign petroleum products, ethanol offered great potential, both as a means to develop new markets for surplus farm production and to satisfy the need for alternative fuels, particularly renewable fuels that were

available domestically at reasonable costs and therefore not subject to the vagaries of international instability.

In the 1970s, to encourage development of the fledgling domestic fuel-ethanol industry, the federal government enacted a variety of economic incentives, among them investment tax credits, loan guarantees, and excise tax exemptions for motor fuel containing alcohol. See, e.g., The Crude Oil Windfall Profit Tax Act of 1980 (Pub.L. 96-223); The Surface Transportation Assistance Act of 1982 (Pub.L. 97-424); The Energy Tax Act of 1978 (Pub.L. 95-618). To ensure that the Act's excise tax exemption encouraged development of the domestic ethanol industry, the exemption was offset for foreign fuel ethanol by the imposition of a duty on the importation of fuel ethanol from foreign countries.[1/] Today, the duty on imported ethanol is 60-cents per gallon. TSUS 901.50.

The domestic industry's response to the need for ethanol and to the economic incentive created by the federal government has been most impressive. From an annual production of approximately 10 million gallons in 1978, the annual domestic production of fuel ethanol has increased by a factor of 50 in six years. In 1984, domestic production reached approximately 500 million gallons. This impressive response has been achieved through the

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1/ Since the excise tax exemption at the time was 4 cents per gallon of the 9-to-1 gasoline-to-ethanol mixture, the effective exemption for a gallon of pure ethanol was 40 cents. Thus, a duty of 40 cents a gallon of pure ethanol was imposed on foreign imports.

construction of a number of new ethanol plants, many of which, such as the plant constructed by New Energy Company of Indiana, have been financed with loans guaranteed by the federal government. Today, there are approximately 120 ethanol plants across the country, representing an investment of more than one billion dollars. Needless to say, this new industry has created thousands of additional jobs, directly in the ethanol producing facilities as well as indirectly in construction, transportation and agriculture. The economic ripple effect from producing 500 million gallons of ethanol is an estimated $2 billion of economic activity in the United States.

The development of the American ethanol industry, moreover, has been of major benefit to American agriculture. A bushel of corn yields 2 1/2 gallons of ethanol.[2/] Thus, production of 500 million gallons of fuel ethanol requires 200 million bushels of corn. This consumption has reduced the significant corn surplus in this country and has increased the depressed market price of corn.[3/] As a result, the federal government has saved many millions of dollars in deficiency

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[2/] Only the starch of corn is used to produce ethanol. All the original proteins, vitamins and minerals are salvaged from the process and concentrated in a residual product that can be used for a variety of purposes, including protein feed, protein gluten meal, and edible corn oil.

[3/] The Department of Agriculture has estimated that the additional consumption of 200 million bushels of corn increases the value of corn by 14 cents a bushel. With an annual domestic production of 7.5 billion bushels, this means an increase in value of over $1 billion.

payments to farmers, as well as storage fees and loan expenses, that would otherwise be required under legislation designed to support farm prices.

The creation and development of a domestic fuel ethanol industry has had a number of other beneficial effects. In addition to increasing domestic economic activity, it has improved our balance of trade,[4/] and generated new tax revenue. The use of ethanol in gasoline contributes to a clean and safe environment by reducing significantly hydrocarbon and carbon monoxide tailpipe emissions and by reducing the need for lead in gasoline. Perhaps most importantly, the development of a domestic fuel-ethanol industry has given the United States a secure and renewable source of energy that is not subject to the constant threat of disruption.[5/]

2. The domestic ethanol industry is still in its infancy and is vulnerable to predatory foreign competition. Its

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[4/] Fuel ethanol has a particularly potent effect on the balance of trade, because of the potential to reduce oil imports and increase value added exports. According to a Resource Planning Associates study for the DOE, gross national product rises $1.89 a bushel when export corn is first processed into ethanol, and its high protein co-products are then exported for foreign food and animal feed use.
Every gallon of fuel ethanol produced domestically can mean up to two fewer gallons of crude oil imported. The use of ethanol-enhanced fuel in 1983 alone reduced the U.S. oil import bill by about $300 million.

[5/] Although there is today no shortage of oil, the potential for future disruption in the imported oil supply is real. A growing fuel ethanol industry, with production facilities dispersed throughout the country, is a buffer against unexpected oil supply interruptions.

survival is jeopardized by huge foreign alcohol surpluses in Brazil, Spain and other countries, which with the help of substantial subsidies and other economic factors, are competing with the domestic industry to meet American demand for fuel grade ethanol. The 60-cent per gallon duty imposed on imported fuel-grade ethanol has been instrumental in holding imports at reasonable levels. However, as of November 1984, importation of ethyl alcohol from Brazil alone for 1984 totalled more than 125 million gallons, approximately double the 1983 level of Brazilian imports.

It is critical to the continued success of federal policy and to the domestic ethanol industry itself, that the duty on imports be enforced as Congress intended. Yet there is substantial reason to believe that large amounts of fuel ethanol are or will soon be imported to this country without full payment of the lawful duty. At least three methods for avoiding payment of duty are being utilized.

(a) CBERA and the GSP. Recent reports in trade papers, corroborated in part by letters obtained from the Customs Service, have disclosed that at least two companies are in the process of establishing ethanol drying operations in the Caribbean for distilling fuel-grade ethanol from non-fuel grade ethanol purchased from Spain, Brazil and elsewhere. As discussed below, these drying operations involve the mere removal of water from alcohol to increase the "proof" of the alcohol. Under Customs Service rulings that are the subject of this petition, this fuel ethanol would be eligible for duty free entry. One company reportedly is building three ethanol drying plants in the Caribbean, which are estimated to have the combined capacity of 40-million gallons of fuel-grade ethanol annually. On December 31, 1984, one of these companies made its first shipment to the Caribbean of approximately 3.5 million gallons of 190-proof alcohol from Spain. Several other enterprises are currently considering the feasibility of such operations.

(b) 19 C.F.R. § 10.131-139. Through November 1984, more than 48 million gallons of ethanol from Brazil alone have been imported into this country designated as being intended for industrial uses.[6/] In contrast to alcohol to be used as a fuel, alcohol to be used industrially is not subject to the 60-cent per gallon duty. There is reason to believe, however, that the domestic demand for imported ethyl alcohol for industrial uses is far less than the 48 million gallons imported from Brazil (see also note 6) and therefore that much of this alcohol is in fact being mixed with gasoline for use as fuel. Under 19 C.F.R. 10.131-139, the importer in that circumstance has up to three years in which to declare the actual use to which the ethanol was put and to pay the required 60-cents per gallon duty, with no interest or penalty. This practice amounts to an interest-free loan from the United States government to the foreign importer of

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[6/] This compares to 18 million gallons imported from Brazil for such purposes in 1983. Other countries import ethanol for industrial purposes as well, including Canada, the United Kingdom and Argentina.

three-year's duty while American producers must borrow at current rates. The Customs Service itself is reported to be concerned that this is happening on a large scale and that it would be difficult to prevent any abuse of these regulatory provisions.

(c) Ethanol already mixed with gasoline. There also is a reason for concern that there is a large scale effort to circumvent the 60-cents per gallon duty on imported fuel ethanol by mixing it with gasoline and then importing it as a motor fuel or other blending component. If permitted, the duty on such a gasoline-alcohol mixture could be as low as 1.25 cents per gallon. TSUS 475.25; *see* TSUS 432.10, 429.70. There are currently efforts by a Brazilian company and others to offer large quantities of gasoline-ethanol blend for importation to the United States free of the 60-cents per gallon duty.

3. This petition addresses the first of these three efforts to avoid payment of the duty -- the utilization of the CBERA and the GSP to obtain duty free entry of fuel ethanol. This effort, particularly in combination with the other two efforts mentioned above, seriously jeopardizes the continued development and possibly the very existence of the domestic fuel ethanol industry. If fuel grade ethanol can be imported duty-free by any of the above means, two results can be predicted with certainty: the volume of foreign fuel ethanol imported into the United States will increase dramatically, and this imported fuel ethanol will reduce the demand for domestic ethanol. Not only would this frustrate important federal policy, but it almost

certainly would have vast adverse economic impact, including the closing of plants (including some financed by loans currently guaranteed by the government), the loss of jobs, the depression of corn prices, and additional secondary economic consequences. Other likely effects are continued dependence on foreign fuel sources, loss of customs duty, increase in government deficiency payments and other costs under farm legislation, loss of tax revenues, and less favorable balance of trade.

In view of these circumstances, petitioners request urgent and expedited consideration of the matters set forth in this petition.

THE RULINGS AT ISSUE

The specific subject of this petition are rulings of the Customs Service reflected in letters dated September 12, 1984 (Reference No. CLA-2 CO:R:CV:V 553209 HS), January 3, 1984 (Reference NO. CLA-2 CO:R:CV:VS 071693 TL), and any other similar ruling. These letters are attached to this petition as Appendix ("App.") A.

The September 12 letter was apparently issued in response to a request for a ruling that 200-proof alcohol distilled in a beneficiary country from 150- to 190-proof alcohol imported from a non-beneficiary country has been "substantially transformed in a beneficiary country" and therefore satisfies the statutory eligibility criterion for duty-free treatment under the CBERA, that an article "be a new or different article of commerce which has been . . . manufactured in the beneficiary country." 19 U.S.C. 2703(a)(2). With respect to this particular question, the Service's September 12 letter stated that 200-proof alcohol is "a new or different article of commerce" when compared to 150- to 190-proof alcohol and that the two-stage process by which water is removed from 150- to 190-proof alcohol to produce 200-proof alcohol is "a substantial manufacturing process."[7/]

These letters were the product of a decision made by the Customs Service without prior notice to interested domestic parties, and without a notice-and-comment period during which domestic producers would have had an opportunity to provide the Service with important data bearing on the questions discussed in the Service's letters.

For the reasons set forth in more detail below, petitioner contends (1) that the Service should not have made the decision reported in its letters until it had considered all relevant information after public notice and a comment period, and thus that the Service should revoke its rulings *nunc pro tunc* pending the completion of such a procedure; and (2) that, in any event, the Service's determination of duty-free eligibility for ethanol supposedly "transformed" in the Carribean is erroneous.

I. RULE MAKING

The letter rulings of the Customs Service that are the subject of this petition have granted a far-reaching exemption

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[7/] *See* Customs Service letter dated September 12, 1984. The letter dated January 3, 1984, addresses a similar question under GSP.

from Customs duties. As previously discussed (pp. 3-11), the Customs Service's rulings will certainly cause severe, widespread damage to the domestic ethanol industry as well as adversely affect important aspects of federal policy and the public interest. The rulings will permit huge volumes of foreign ethanol to flood the United States duty-free, undercutting the prices of domestic producers and potentially driving American producers out of the market and in many cases out of business. Most certainly it will frustrate explicit federal objectives by precluding expansion of domestic production. Given the ease with which a drying facility in the Caribbean can be established, the Service's ruling will create a great incentive for producers from all foreign nations to funnel their products through Caribbean facilities.

Petitioners contend that, under these circumstances, the Service should immediately revoke or otherwise withdraw its letter rulings regarding the eligibility of fuel ethanol for duty free entry under the CBERA and the GSP and should make its decision in this matter only after notice and a comment period has afforded to the Service the opportunity to consider a full and accurate record. Petitioners have been informed that the notice and comment procedures that will be triggered by this petition may take many months, if not years, to complete. If the erroneous letter rulings at issue are allowed to remain in effect during this period, serious and irreparable damage will result to petitioners because they may be forced from the market by the flood of foreign ethanol. Both the Administrative Procedure Act and the common law of administrative procedure dictate that the interested public be given a chance to comment before the agency adopts such a rule. The Service's own regulations also require the same result.

The Administrative Procedure Act ("APA") requires an agency to publish notice of a proposed rule making and to "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation." 5 U.S.C. 553 (b), (c). These statutory requirements apply when the agency promulgates a "substantive," as opposed to an "interpretative," rule. See 2 K. Davis, Administrative Law Treatise §7:8, at 39 (1979); Chrysler Corp. v. Brown, 441 U.S. 281, 301-303 (1979); General Electric Co. v. Gilbert, 429 U.S. 125 (1976); United States Dept. of Labor v. Kast Metals, 744 F.2d 1145, 1152 (5th Cir. 1984). In this instance, the Caribbean Basin Economic Recovery Act delegates to the Secretary of the Treasury broad authority to issue regulations regarding the law on the duty-free treatment of Caribbean products. See 19 U.S.C. 2703(a)(1) (providing that the Secretary of the Treasury "shall prescribe such regulations as may be necessary to carry out this subsection"). The rulings in issue in this case were made pursuant to this "power to make law through rules" (2 K. Davis, supra) that was delegated to the Secretary; they thus should be regarded as substantive rules, thereby invoking the procedural requirements of Section 553 of the APA. Because the Service did not meet those requirements by providing notice and an opportunity to comment before the Service issued its rule on ethanol, the rules are invalid.

In any event, regardless of the applicability of the APA, the common law of administrative procedure requires the Customs Service to give prior notice and an opportunity for interested parties to comment when, as here, the proposed agency rule will have a substantial impact on interested persons. As several courts have explained, "elementary fairness" requires a notice and comment procedure in this circumstance. See Independent Broker Dealers Trade Ass'n v. S.E.C., 442 F.2d 132, 144 (D.C. Cir.), cert. denied, 404 U.S. 828 (1971) (notice and comment procedure may be required for proposed SEC action having impact on stock brokers who are not members of securities exchange and therefore have no say in the decision); Stearns Electric Paste Company v. E.P.A., 461 F.2d 293, 304 (7th Cir. 1972) ("agency acted properly in soliciting comments" from industry on its proposed policy statement); Pharmaceutical Manufacturers Ass'n v. Finch, 307 F. Supp. 858, 863-64 (D. Del 197) (notice and comment procedure required for FDA regulations having substantial impact on drug industry); National Motor Freight Traffic Ass'n v. United States, 268 F. Supp. 90, 95-97 (D.D.C. 1967); 1 K. Davis, Administrative Law Treatise, supra, §6:31, at 597 (approving common law requirement of notice and comment where proposed regulation will have substantial impact). *See also* 2 *K. Davis*, *supra*, §§7:16, 7:17.[8]

Moreover, petitioners submit that the letter rulings were not issued in accordance with the Service's own internal regulations and, therefore, they must be revoked *nunc pro tunc*. Pursuant to 19 C.F.R. §177.9(b), "[e]ach ruling letter is issued on the assumption that all of the information furnished in connection with the ruling letter, either directly, by reference, or by implication, is *accurate and complete in every material respect*" (emphasis added). The ruling must be modified or revoked if it is later determined to be erroneous and it must be modified or revoked retroactively if the request for the ruling contains an omission of material facts or if the facts subsequently developed are materially different from those on which the ruling was based. *Id*. §177.9(d).

As discussed below in Part II of this petition, we believe the Service was not presented with "a complete statement of all relevant facts relating to the transaction," as the

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[8] *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council*, 435 U.S. 519 (1978), holds that when section 553 applies, a court may not require an agency to adopt procedural steps beyond the notice and comment process delineated in the APA. But *Vermont Yankee* does not prevent a court from requiring a notice and comment procedure in the appropriate situation, when section 553 does not apply. *See* 1 *K. Davis*, *supra*, §7:19 at 94; *cf*. *United States Dept. of Labor* v. *Kast Metals*, 744 F.2d 1145, 1153 (5th Cir. 1984) (applying substantial impact test after *Vermont Yankee*).

Service's regulations require.[9] 19 C.F.R. §177.2(b)(1). It is doubtful that the Service was advised of the identities of "all interested parties," id., including these petitioners as well as others. Nor is it likely that the Service was presented with complete material facts concerning the impact of the proposed ruling on the domestic economy or on important federal policies. If the factual record on these and other critical issues was not complete, the basis for the ruling falls short of the standards reflected in 19 C.F.R. §177.9, and the ruling must be revoked pursuant to 19 C.F.R. §177.9(d) until all interested parties have an opportunity to provide the Service with the required record, "accurate and complete in every material respect."[10]

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[9] On January 22, 1985, counsel for petitioners filed an FOIA request for copies of the requests for ruling, the attachments and other submissions made in connection with the requests, and other pertinent documents. In response, the Service has indicated that the requests and any accompanying documents are either entirely or partially exempt from disclosure.

[10] At a minimum, the Service should refrain from publishing its letter rulings, or from issuing additional ones, until there has been notice and an opportunity for interested parties to make submissions with respect to the correctness of the contemplated ruling. Under 19 C.F.R. §177.10(c)(1), these procedures are required when "the contemplated change of practice will result in the assessment of a lower rate of duty and the Headquarters Office determines that the matter is of sufficient importance to involve the interests of domestic industry." Certainly the contemplated letter rulings, under which foreign fuel ethanol would become eligible for duty free entry, meet the requirements set forth in this regulation.

Even if the ruling is not contrary to the Service's regulations, the Service should, under the unique facts of this case, revoke the ruling *nunc pro tunc* and provide interested persons with a chance to comment. Fundamental fairness dictates that a ruling having such a profound impact on important domestic interests not be the result of an *ex parte* secret record (see note 9, above), but rather be the subject of a public notice and comment procedure. The opportunity to participate is especially crucial when the parties who would be injured have access to economic data that bears directly on the regulatory policy.

II. THE SERVICE'S DECISION

Petitioners contend that the distillation processes described in the Service's September 12 letter do not meet the statutory criteria of the Carribean Basin Economic Recovery Act. As the September 12 letter states, to be eligible for duty-free treatment as "a new or different article of commerce which has been . . . manufactured in the beneficiary country," alcohol imported from a nonbeneficiary country must meet two separate criteria: (a) the alcohol must be processed in the beneficiary country into "a new or different article of commerce"; and (b) the process by which this occurs must be, as the Service's letter puts it, a "substantial manufacturing process." Although these two criteria are analytically distinct, they also are related. As the Supreme Court stated long ago in *Anheuser-Busch Brewery Association* v. *United States*, 207 U.S. 556, 562 (1908):

> Manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labor and manipulation. But something more is necessary . . . . There must be transformation; a new and different article must emerge . . . .

As discussed below, 200-proof ethanol is not a "new and different article" when compared with 150- to 190- proof alcohol and the distillation process used does not constitute a substantial manufacturing process within the meaning of the statute.[11/]

A. New or Different Article of Commerce

In its September 12 letter, the Service refers to "beverage grade ethanol" and "motor fuel ethanol" as being different. But these labels are nothing more than names for the same thing -- ethyl alcohol. The only significant difference in the composition of the two is their proof and this is determined merely by how much water is in the alcohol.

The "proof" of alcohol is a measure of its alcoholic content: 150-proof alcohol contains 75 percent alcohol; 190-proof alcohol contains 95 percent alcohol; 200-proof alcohol is pure. The only material difference between 200-proof alcohol and the 150- to 190-proof alcohol at issue is the amount of nonalcohol each contains.

[11/] This petition will concentrate on the more recently enacted CBERA. If the Customs Service agrees with this analysis, the same conclusion would pertain under the similarly worded GSP.

Moreover, nearly all of the nonalcohol in ethyl alcohol is water. Whereas 150- to 190-proof alcohol contains 5 percent or more water, 200 proof alcohol contains .25 percent or less water. Thus, one has only to remove the water from 150- to 190-proof alcohol to obtain 200-proof alcohol; likewise, one would only have to add water to 200-proof alcohol to obtain a lower proof alcohol.

In all other respects, the specifications and properties of the two materials are virtually identical. Attached to this petition as App. B are the specifications and properties of 190- and 200-proof ethyl alcohol published by U.S.I., a domestic producer.[12/] A comparison of the specifications and properties of the two alcohols readily demonstrates that there is virtually no difference other than the amount of water each contains.

For this reason, 200-proof alcohol distilled from 150- to 190-proof alcohol obviously is neither "new" nor "different." While such alcohols may have different end uses, there is no significant difference in the composition of the two other than the amount of water removed. They cannot be said to have distinct characteristics or to be substantially transformed, as the law requires. The mere removal of water from an article does not so change the character of the article as to transform it into "a new or different article of commerce."

[12/] Source: Ethyl Alcohol Handbook (5th ed.) (National Distillers and Chemical Corp. Pub.)

The Service's September 12, 1984, letter concentrates on the "different end uses" of 150- to 190-proof alcohol and 200-proof alcohol. But both alcohols are potable, and both have potential fuel uses.[13/] It is true that 150- to 190-proof alcohol is more suitable for use as a beverage and 198+ proof alcohol is required for mixing with gasoline. But this should not be the basis for finding them new and different, especially where, as here, there is so little difference in the identity, composition and characteristics of the two.

Prior Customs law precedent in related areas strongly supports this contention. In Anheuser-Busch Brewery v. United States, for example, the Supreme Court considered whether a multi-stage process by which raw cork was made suitable for use as caps for beer bottles constituted a sufficient transformation of the cork to entitle it to preferential Customs treatment. Although the record clearly demonstrated that only the processed cork was suitable for capping use, the Court rejected the claim. Holding that "a new and different article must emerge," the Court stated that this "cannot be said of the corks in this case. A cork put through the claimant's process is still a cork." 207 U.S. at 562.

[13/] Fuel ethanol is made nonpotable by the addition of a denaturant, such as gasoline. Denaturing is required by the Bureau of Alcohol, Tobacco and Firearms to render otherwise potable fuel ethanol unfit for human consumption and thus to ensure that the fuel ethanol is not diverted for use as a beverage without payment of the alcoholic beverage excise tax.

The same must be said of the ethanol at issue in this case. Although there is less water in 200-proof ethanol and as a result it may be more suitable for certain specific uses, 200-proof ethanol is not "a new or different article" when compared to 150- to 190-proof alcohol. To paraphrase the Supreme Court, "[ethanol] put through the claimant's process is still [ethanol]."[14]

More recent Customs' cases confirm that to qualify as a new or different article, the article must obtain a new identity. See Belcrest Linens v. United States, 741 F.2d 1368 (Fed.Cir. 1984); Torrington Company v. United States, (U.S. C.I.T. 1984). Here, the identity of the product remains the same. After the processing, it is still alcohol, with a little less water.

B. Substantial Manufacturing Process

In any event, the process by which 200-proof alcohol is derived from 150- to 190-proof alcohol is not a substantial manufacturing process within the meaning of the applicable law. The term "manufactured," as used in the CBERA and its regulations, means that the process to which the imported product is subjected in the beneficiary country must be more than merely a minor operation. The purpose of this provision, as the legislative history states explicitly, "is to prevent pass-through operations in which the work performed is of little economic benefit to the Caribbean and constitutes avoidance of U.S. duties." 1983 U.S. Code Cong. & Admin. News, vol. 2, p. 654 (House Report No. 98-266).

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[14] Relying on the Anheuser-Busch case, the Bureau of Alcohol, Tobacco and Firearms has recently ruled under 26 U.S.C. 7652 that the further distillation of alcohol beverages in Puerto Rico does not constitute a substantial change in the beverage and thus that the beverage is not an article produced in Puerto Rico entitling it to preferential treatment. ATF Rul. 83-4. The same analysis is applicable to the distillation processes at issue in this case.

Both the statute and the regulations refer to the "mere dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article" as examples of a minor operation that would not satisfy the statutory requirement. 19 U.S.C. 2703(a)(2); see 19 C.F.R. §10.195(a). The legislative history of the CBERA refers to other examples, among them "simply fitting together a small number of components by bolting, glueing, soldering, etc.; . . . merely blending . . ., merely chopping or thrashing . . .; merely diluting chemicals with inert ingredients to bring them to standard degrees of strength; or the addition of substances such as . . . wetting agents, etc." 1983 U.S. Code Cong. & Admin. News, supra.

It is important to distinguish the process of fermentation of alcohol from corn, sugar cane or other agricultural product, and the drying of the alcohol. Both are components of an overall process that transforms the agricultural product into 200-proof alcohol, but they are very different in terms of their significance and their impact on the final product. The fermentation process generally is more elaborate and expensive and results in the substantial transformation of the corn, sugar cane or other product into what is truly a "new or different article of commerce," that is, alcohol. The drying process, on the other hand, is a relatively simple inexpensive procedure that comes at the very end of the overall process, and that, as discussed above, does not result in a substantial transformation. The establishment of a full fermentation plant in a Carribbean country might be of potentially significant economic benefit to the Carribbean and therefore qualify as a substantial manufacturing process. As explained below, however, a mere alcohol drying operation is not of significant economic benefit and should not be construed as qualifying.

As the Service's letter indicates, 200-proof alcohol is obtained from 150- to 190-proof alcohol simply by removing water through a two-stage distillation process. In general, in both stages alcohol is separated from water in distillation columns in which the liquid is heated, causing one of the components to vaporize. In the first stage, the alcohol, having a lower boiling point than water, vaporizes first and is thereby separated from most of the water. The enriched alcohol vapor is removed from the top of the column and condensed into liquid form; the water is drained from the bottom of the column. Because it is chemically impossible to separate all of the water from the alcohol in this one process, the remaining water is removed in a second stage. Although there are several ways to do this, one common method -- the "azeotropic" method -- involves adding benzene or some other chemical to the 190-proof alcohol and resubjecting it to essentially the same distillation process as before. When this mixture is heated, the benzene, which has a lower boiling point than alcohol, carries away most or all of the remaining water. The benzene/water vapor is taken from the top of the column and condensed; the benzene separates from the water and can be recirculated. The 200-proof alcohol is taken from the bottom of this column and is ready for use as fuel-grade ethanol.

The two distillations columns are very similar; the process employed is simple; the technology is rudimentary; the distillation process can be fully automated and requires only minimal supervision.

The Service states in its September 12 letter that the first of these drying processes, in which 190-proof alcohol is distilled from 150- to 190-proof alcohol, "is not a substantial enough operation" to allow the 190-proof alcohol to be included as a constituent material for purpose of satisfying one of the other CBERA requirements relating to valuation. See 19 U.S.C. 2703(a)(1)(B); 19 C.F.R. §10.196(a)(2). Under the regulations, the same analysis applies to the ultimate issue whether the overall operation in the beneficiary country is substantial enougn to qualify the article for duty-free treatment. However, just as the first step of the drying process "is not a substantial enough operation," the second step, in which the 190 proof alcohol is further dried by the addition of benzene, is insufficient, alone or together with the first stage, to qualify.

The process by which alcohol is dried is no more of an "operation" than the activities mentioned in the statute, regulations, and legislative history as illustrations of what does not constitute a substantial manufacturing process. For example, mere removal of water from ethanol should not be treated differently from "mere dilution with water," which is specifically excluded by statute. Under this provision of the statute, the dilution of 200-proof alcohol to 150-proof alcohol by the addition of water would not qualify as a substantial manufacturing process. By the same token, removing water from 150-proof alcohol to create a higher alcoholic content, whether it be 190-proof or 200-proof, also is not a substantial manufacturing process. The process of drying the alcohol by adding benzene is similar to the addition of substances to chemicals "to bring them to standard degrees of strength," or to "the addition of substances such as . . . wetting agents." See 1983 U.S. Code Cong. & Admin. News, supra.

In terms of the technology and capital investment involved, this drying process is essentially similar to "simply fitting together a small number of components," "mere blending," and "mere chopping or thrashing." Id. In addition, the principal components of the necessary distillation equipment are being purchased in the United States and merely set up in the Caribbean, requiring little or no technical know-how. As indicated above, moreover, few if any jobs would be created. Thus, the establishment of these drying operations is of little economic benefit to the Carribean economy.

Moreover, the overall cost of such an operation is not significant. The cost per gallon of distilling 200-proof alcohol from 150- to 190-proof alcohol is only a small fraction of the amount of the duty. Indeed, instead of paying the 60 cents per gallon duty, it would be cheaper for holders of 200 proof ethanol in countries such as Brazil to water the alcohol down, ship it to a Caribbean drying operation, take the water out again, and import it to this country duty-free under the CBERA. Presumably, this is not likely to occur; instead, the foreign producer is likely simply to defer the final distillation stage until the alcohol is shipped to the Caribbean country. The point is that the final stage of drying is an extremely minor component of the final cost of the alcohol.[15/]

These factors must be considered by the Service in making its ultimate decision. The distillation process to be performed in the beneficiary countries is precisely the type of

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[15/] An additional eligibility requirement of the CBERA is that "the sum of (i) the cost or value of the materials produced in a beneficiary country . . ., plus (ii) the direct cost of processing operations performed in a beneficiary country . . . is not less than 35 per centum of the appraised value [of the imported] article at the time it is entered." 19 U.S.C. 2703; see 19 C.F.R. 10.195-96. Even if an entry of fuel ethanol from the Caribbean is determined to be otherwise eligible for duty-free treatment, petitioner urges the Service to audit compliance with this requirement carefully. Petitioner further requests opportunity to monitor this process of verification and calculation.

insubstantial activity the express language of the Caribbean Basin Economic Recovery Act was designed to exclude: "a pass-through operation[ ] in which the work performed is of little economic benefit to the Caribbean and constitutes avoidance of U.S. duties." Id. As indicated above, there is evidence that such avoidance is being planned on a large scale, with potentially serious consequences to domestic ethanol producers, to American agriculture, and to the general American public.

CONCLUSION

Petitioners request that the Customs Service act without delay on this petition.[16] For the reasons set forth above, the Service should immediately revoke *nunc pro tunc* the rulings reflected in its letters dated September 12, 1984 (Reference No. CLA-2 CO:R:CV:V 553209 HS) and January 3, 1984 (Reference No. CLA-2 CO:R:CV:VS 071693 TL), and any similar rulings concerning the eligibility of certain fuel-grade ethanol for duty-free entry under the Caribbean Basin Economic Recovery Act and the Generalized System of Preferences and should institute formal procedures to allow a thorough public consideration of this issue. In any event, the Service should rule that 200-proof alcohol imported from a beneficiary country but derived from 150- to 190-proof alcohol produced in a nonbeneficiary country is not eligible for duty-free entry under either CBERA or GSP. Alcohol with a proof of 200 is not a "new" or "different" article of commerce compared with 150- to 190-proof alcohol. The process by which 200-proof alcohol is derived from 150- to 190-proof alcohol does not constitute a substantial manufacturing process.

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[16] Petitioners reserve the right to supplement this petition as additional material becomes available in response to Freedom of Information Act requests and other inquiries.

Respectfully submitted,

WILLIAMS & CONNOLLY

Aubrey M Daniel III
Aubrey M. Daniel, III

Stephen L. Urbanczyk

Manley W. Roberts
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839 17th Street, N.W.
Washington, D.C. 20006
(202) 331-5000

Attorneys for Petitioners

January 29, 1985

IT OF THE TREASURY
CUSTOMS SERVICE
WASHINGTON

REFER TO
CLA-2 CO:R:CV:V
553209 HS

12 SEP 1984

This is in response to your letters of July 19, July 23, and August 13, 1984, concerning the eligibility for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA) of fuel grade ethanol (also known as ethyl alcohol). You request a ruling that the motor fuel grade ethanol has been substantially transformed in a beneficiary country and seek verification that the costs that your client intends to include in the calculation of the 35 percent value content requirement are appropriate.

Your client will import into a beneficiary country beverage ethanol produced in beneficiary countries and non-beneficiary countries. The proof of the beverage ethanol will range from 150 to 190. Because of its high water content, the beverage ethanol is not usable as motor fuel.

Your client plans to have a distillery located in a beneficiary country process the beverage ethanol to anhydrous ethanol through a two-stage distillation process. The first stage of the process will distill the ethanol to 190+ proof, less than 5 percent water, using a standard distillation column. The second stage will process the ethanol through an aziotropic distillation column which will separate the ethanol-water aziotrope and distill the ethanol to 199.5 proof, 0.25 percent water.

In addition, after distillation, your client is considering denaturing the motor fuel grade ethanol by adding gasoline. The gasoline will be produced and added to the distilled ethanol in a beneficiary country. The motor fuel grade ethanol will then be exported directly to the United States.

First, we will address whether the motor fuel ethanol has been substantially transformed in a beneficiary country. An article is substantially transformed for tariff and related purposes when, as a result of a substantial manufacturing or processing operation, a new or different article of commerce emerges having a name, character or use which is distinct from the article or material from which it was so transformed.

The original beverage grade ethanol and the produced motor fuel ethanol have different end uses. Beverage ethanol cannot be used as motor fuel because of its high water content, and it is not economically feasible to use motor fuel ethanol for beverage use. Within the trade, motor fuel ethanol is considered to be a different article of commerce which is significantly more valuable than beverage ethanol. Accordingly, as the motor fuel grade ethanol is a new and different article of commerce from the beverage grade ethanol, and is produced through a substantial manufacturing process, it is our view that the processing of the beverage grade ethanol into motor fuel ethanol involves a substantial transformation.

Regarding the 35 percent value-content requirement, duty-free treatment of the goods imported into the United States applies only if the sum of the cost or value of the materials produced in a beneficiary country or countries plus the direct costs of processing operations performed in such country or countries is not less than 35 percent of the appraised value of such article. To be included in the 35 percent, a constituent material of the eligible article which is not wholly the growth, product or manufacture of the beneficiary country must have undergone a substantial transformation in the beneficiary country. The material resulting from that substantial transformation must then be used in the production or manufacture of a new or different article, i.e., the article imported into the United States.

In this case, for the 190+ proof beverage grade ethanol to be considered, a constituent element of the eligible article, motor fuel ethanol, it must have undergone a substantial transformation in a beneficiary country. It is our view that transforming 150-190 proof beverage grade ethanol to 190+ proof beverage grade ethanol through a simple distillation process is not a substantial enough operation to make the 190+ proof beverage grade ethanol a substantially transformed constituent material. Accordingly, the cost of the 150-190 proof beverage grade ethanol which was not produced in a beneficiary country may not be included in the computation of the 35 percent value-content requirement.

If not included in the manufacturer's actual cost for the materials, the cost of transporting the beverage ethanol that originates from beneficiary countries to the distillery as well as the cost of transporting to the distillery any gasoline that is used as a denaturant and that is produced in a beneficiary country may be included in the computation of the 35 percent value-added requirement. Further, the cost or value of the gasoline itself produced in a beneficiary country and used as a denaturant may also be included. If there is segregation of the beverage ethanol that originates in non-beneficiary countries and that which originates in beneficiary countries, the actual cost of any waste of the beverage ethanol from beneficiary countries in terms of product shrinkage may also be included.

Other costs that may be included in the computation of the 35 percent value content are the direct costs of processing the 150-190 proof beverage ethanol to motor fuel ethanol, including fuel costs, labor costs (including fringe benefits and on-the-job training) and equipment depreciation and amortization which are allocable to the specific merchandise.

Sincerely,

John Durant

For Harvey B. Fox
Director, Classification
and Value Division

BEST COPY AVAILABLE

U.S. CUSTOMS SERVICE
WASHINGTON

JAN 03 1984

REFER TO
CLA-2 CO:R:CV:VS
071693 TL

Dear

According to your December 19, 1983 letter, your client intends to import undenatured ethyl alcohol of between 180 and 190 proof into the Virgin Islands and dehydrate it by a series aziotropic distillation process to yield alcohol of 199+ proof for use as a motor vehicle fuel.

According to your letter, the 180 to 190 proof alcohol imported into the Virgin Islands is incapable of being used as a motor vehicle fuel. Benzene is added to this alcohol during its dehydration to permit the removal of water therein. Upon dehydration 199+ proof alcohol is produced. This, according to the trade is considered to be a different article of commerce which is significantly more valuable than the 180 to 190 proof alcohol imported into the Virgin Islands.

We are of the opinion that the processing to be performed in the Virgin Islands is sufficient to result in a product thereof for the purpose of General Headnote 3(a), Tariff Schedules of the United States, (TSUS).

Accordingly, the 199+ proof ethyl alcohol will be entitled to duty-free treatment under General Headnote 3(a), TSUS if you comply with all of the other requirements in the Headnote and in section 7.8 Customs Regulations.

Sincerely,

Irving W. Smith, Jr.

for Harvey B. Fox
Director, Classification
and Value Division

App. A-2

Pure ethyl alcohol is supplied in both the 190 proof and anhydrous form. It is available on a tax-paid basis, or for authorized users it may be obtained tax-free. In addition to meeting the U.S.I. quality requirements, U.S.I. can supply pure alcohol meeting various defined, industry accepted specifications.

Over 75 years of experience in making and selling the highest quality alcohol assure U.S.I. customers of the benefits of quick delivery, certainty of supply, and experienced assistance with regulatory and technical questions.

U.S.I. Specifications

	Units	190 Proof	200 Proof (Anhydrous)	Test Method
Ethyl Alcohol, minimum strength	vol %	95	99.9	I.R.S. Gauging Manual
Acidity as Acetic Acid, maximum	g/100 ml	0.0025	0.0025	ASTM D-1613
Non-Volatile Matter, maximum	g/100 ml	0.0025	0.0025	ASTM D-1353
Permanganate Time, minimum	minutes	50	30	U.S.I.
Specific Gravity at 60°F, (15.56°C/15.56°C) maximum		0.816	0.794	ASTM D-891
Color, maximum	Pt-Co	10	10	ASTM D-1209
Odor	(free from foreign odors)			Organoleptic

Typical Properties

	Units	190 Proof	200 Proof (Anhydrous)
Boiling Point	°C °F	78.3 172.9	78.4 173.1
Coefficient of Expansion			
Per °C		0.0011	0.0011
Per °F		0.00062	0.00062
Flash Point			
ASTM D-1310 (Tag Open Cup)	°C °F	21 69	18 65
ASTM D-56 (Tag Closed Cup)	°C °F	17 62	14 57
Weight per Gallon at (15.56°C) 60°F, in lbs.		6.794	6.610
Water Solubility	soluble in all proportions		

[illegible] Information

EXHIBIT D

of the proposed area is not expected to exceed 0.1 millidarcy;

(2) The stabilized production rate, against atmospheric pressure, of wells completed for production from the recommended formation, without stimulation, is not expected to exceed the maximum allowable production rate set out in § 271.703(c)(2)(i)(B); and

(3) No well drilled into the recommended formation is expected to produce more than five (5) barrels of oil per day.

Colorado further asserts that existing State and Federal Regulations assure that development of this formation will not adversely affect any fresh water aquifers.

Accordingly, pursuant to the authority delegated to the Director of the Office of Pipeline and Producer Regulation by Commission Order No. 97 [Reg. Preambles 1977–1981], FERC Stats. and Regs. ¶ 30.180 (1980), the Director gives notice of the proposal submitted by Colorado that the Niobrara Formation, as described and delineated in Colorado's recommendation as filed with the Commission, be designated as a tight formation under § 271.703.

IV. Public Comment Procedures

Interested persons may comment on this proposed rulemaking by submitting written data, views or arguments to the Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426, on or before May 23, 1985. Each person submitting a comment should indicate that the comment is being submitted in Docket No. RM79–76–245 (Colorado-40 Addition), and should give reasons including supporting data for any recommendations. Comments should include the name, title, mailing address, and telephone number of one person to whom communications concerning the proposal may be addressed. An original and 14 conformed copies should be filed with the Secretary of the Commission. Written comments will be available for public inspection at the Commission's Division of Public Information, Room 1000, 825 North Capitol Street, NE., Washington, D.C., during business hours.

Any person wishing to present testimony, views, data, or otherwise participate at a public hearing should notify the Commission in writing that they want to make an oral presentation and so request a public hearing. The person shall specify the amount of time requested at the hearing, and should file the request with the Secretary of the Commission no later than April 23, 1985.

List of Subjects in 18 CFR Part 271

Natural gas, Incentive price, Tight formation.

Accordingly, the regulations in Part 271, Subchapter H, Chapter I, Title 18, *Code of Federal Regulations*, will be amended as set forth below, in the event the Commission adopts Colorado's recommendation.

Kenneth A. Williams,

Director, Office of Pipeline and Producer Regulation.

PART 271—[AMENDED]

Section 271.703 is amended as follows:

1. The authority citation for Part 271 reads as follows:

Authority: Department of Energy Organization Act, 42 U.S.C. 7101 *et seq.*; Natural Gas Policy Act of 1978, 15 U.S.C. 3301–3432; Administrative Procedure Act, 5 U.S.C. 553.

2. Section 271.703 is amended by revising paragraph (d)(210) to read as follows:

§ 271.703 Tight formations.

* * * * *

(d) *Designated tight formations.* * * *

* * * * *

(210) *Niobrara Formation in Colorado.* RM79–76–245 (Colorado-40 Addition).

(i) *Delineation of formation.* The Niobrara Formation is located in Adams County, Colorado, in Township 1 South, Range 67 West, Sections 1 through 36; Township 1 South, Range 68 West, Sections 25 through 36; and in Weld County, Colorado, in Township 1 North, Range 67 West, Section 32 S/2, 6th P.M.

(ii) *Depth.* The average depth to the top of the Niobrara Formation is 7,500 feet. The Niobrara Formation varies in thickness from 250 to 450 feet.

[FR Doc. 85–8566 Filed 4–10–85; 8:45 am]

BILLING CODE 6717-01-M

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Part 175

Receipt of Domestic Interested Party Petition Concerning Tariff Classification of Certain Fuel Grade Ethanol

AGENCY: U.S. Customs Service, Department of the Treasury.

ACTION: Notice of receipt of domestic interested party petition; solicitation of comments.

SUMMARY: Customs has received a petition submitted on behalf of several domestic interested parties with respect to Customs determination that certain fuel grade ethanol imported from several Caribbean Basin countries may qualify for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA). The petitioners contend that the ethanol is currently incorrectly classified under the CBERA as being eligible for duty-free entry into the U.S. They believe that the beverage grade ethanol transformed to fuel grade ethanol in the Caribbean Basin countries is not subjected to a "substantial manufacturing process" and does not produce a "new or different article of commerce". Therefore, they believe the duty prescribed for ethanol in the tariff schedules should be collected. This document invites comments addressing the correctness of the current classification.

DATE: Comments must be received on or before June 10, 1985.

ADDRESS: Comments (preferably in triplicate) may be submitted to the Commissioner of Customs, Attention: Regulations Control Branch, Room 2426, 1301 Constitution Avenue, NW., Washington, D.C. 20229 (202–566–8237).

FOR FURTHER INFORMATION CONTACT: Harold Singer, Classification and Value Division, U.S. Customs Service, 1301 Constitution Avenue, NW., Washington, D.C. 20229 (202–566–2938).

SUPPLEMENTARY INFORMATION:

Background

Pursuant to section 516, Tariff Act of 1930, as amended (19 U.S.C. 1516), a domestic interested party petition has been filed with respect to Customs determination that certain fuel grade ethanol imported from several Caribbean Basin countries may qualify for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA; 19 U.S.C. 2701). The product at issue, ethyl alcohol (ethanol) imported for use as a fuel, is classified under item 901.50, Tariff Schedules of the United States (TSUS; 19 U.S.C. 1202), at a rate of duty of 60¢ per gallon. (This 60¢ per gallon duty is in addition to a 3% ad valorem duty on ethanol for nonbeverage purposes from item 427.88, TSUS). However, some ethanol may enter the U.S. free of duty since Customs has ruled that the transformation of beverage grade ethanol from a non-beneficiary country to motor fuel ethanol in a beneficiary country through azeotropic distillation is sufficient to make the motor fuel ethanol a product of the beneficiary country for purposes of the CBERA.

The petitioners contend that fuel grade ethanol is not a new or different article of commerce from beverage grade ethanol as the only significant difference in the composition of the two is their water content. It is argued that azeotropic distillation is not a substantial manufacturing process. The azeotropic method of distillation involves adding benzene or some other chemical to 190 proof ethanol and then heating the mixture so that the benzene will vaporize and carry away most or all of the water in the mixture. This results in ethanol of a higher proof.

The possibility that importers will import ethanol free of duty is the result of two previous Customs ruling letters. In Customs letter CLA-2 CO:R:CV:V, 553209 HS, September 12, 1984, it was stated that an article is substantially transformed for tariff and related purposes when, as a result of a substantial manufacturing or processing operation, a new or different article of commerce emerges having a name, character, or use which is distinct from the article or material from which it is transformed. Applying this definition, it was determined that azeotropic distillation is a substantial processing operation and fuel grade ethanol was a different product from beverage grade ethanol.

In Customs letter CLA-2 CO:R:CV:VS, 071693 TL, January 3, 1984, it was determined that General Headnote 3(a), TSUS, would afford duty-free entry to 199+ proof alcohol that had been produced from 180–190 proof alcohol after azeotropic distillation performed in the U.S. Virgin Islands.

Comments

Pursuant to § 175.21(a), Customs Regulations (19 CFR 175.21(a)), before making a determination on this matter, Customs invites written comments from interested parties on the classification issue.

The domestic interested party petition, as well as all comments received in response to this notice, will be available for public inspection in accordance with the Freedom of Information Act (5 U.S.C. 552), § 1.8, Treasury Department Regulations (31 CFR 1.8), and § 103.11(b), Customs Regulations (19 CFR 103.11(b)), between the hours of 9:00 a.m. and 4:30 p.m. on normal business days, at the Regulations Control Branch, Headquarters, U.S. Customs Service, 1301 Constitution Avenue, NW., Room 2428, Washington, D.C. 20229.

Authority

This notice is published in accordance with § 175.21(a), Customs Regulations (19 CFR 175.21(a)).

Drafting Information

The principal author of this document was John E. Doyle, Regulations Control Branch, U.S. Customs Service. However, personnel from other Customs offices participated in its development.

William von Raab,
Commissioner of Customs.

Approved April 2, 1985.

John M. Walker, Jr.,
Assistant Secretary of the Treasury.

[FR Doc. 85-8709 Filed 4-10-85; 8:45 am]

BILLING CODE [illegible]

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

23 CFR Part 635

[FHWA Docket No. 85–17]

Contract Procedures; Advertising for Bids; Noncollusion Affidavit

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Proposed rule; correction.

SUMMARY: This document corrects a proposed rule on contract procedures regarding advertising for bids that appear at page 12037 in the **Federal Register** on Wednesday, March 27, 1985 (50 FR 12037). The action is necessary to correct a typographical error in the docket number given under the "**ADDRESS**" heading to read as "Docket No. 85–17."

DATE: Comments on the proposed rule must be submitted on or before May 28, 1985.

ADDRESS: Submit written comments, preferably in triplicate, to FHWA Docket No. 85–17, Federal Highway Administration, Room 4205, HCC–10, 400 Seventh Street, SW., Washington, D.C. 20590. All comments and suggestions received will be available for examination at the above address between 7:45 and 4:15 p.m., ET, Monday through Friday, except legal holidays. Those desiring notification of receipt of comments must include a self-addressed, stamped postcard.

FOR FURTHER INFORMATION CONTACT: Mr. P. E. Cunningham, Chief, Construction and Maintenance Division, (202) 426–0392, or Mr. Hugh T. O'Reilly, Office of the Chief Counsel, (202) 426–0780. Office hours are from 7:45 to 4:15 p.m., ET, Monday through Friday.

In FR Doc. 85–7212 appearing on page 12037 in the issue of March 27, 1985, under the heading of "**ADDRESS**" the docket number "84–14" is corrected to read as "85–17."

Issued on: April 3, 1985.

Dewell H. Anders,
Acting Chief Counsel, Federal Highway Administration.

[FR Doc. 85–[illegible] Filed 4–10–85; 8:45 am]

BILLING CODE [illegible]

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23 CFR Part 650

[FHWA Docket No. 85–21]

Navigational Clearances for Bridges

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: The FHWA requests comments on a proposal to issue regulations for the coordination and development of Federal-aid highway projects which effect navigation. The regulations will summarize existing policies and procedures regarding the construction of bridges over navigable waterways. The purposes of this document is to strengthen and improve the coordination between highway interests and waterway interests, and to achieve cost-effective designs. The regulation will be issued as a part of a comprehensive effort by FHWA to streamline and accelerate the planning and developmental processes on Federal-aid highway projects under the "one stop" processing concept.

DATE: Comments must be received on or before July 10, 1985.

ADDRESS: Submit written comments, preferably in triplicate, to FHWA Docket No. 85–21, Federal Highway Administration, Room 4206, HCC–10, 400 7th Street, SW., Washington, D.C. 20590. All comments received will be available for examination at the above address between 7:45 a.m. and 4:15 p.m. ET, Monday through Friday, except legal holidays. Those desiring notification of receipt of comments must include a self-addressed, stamped postcard.

FOR FURTHER INFORMATION CONTACT: Mr. Philip L. Thompson, Office of Engineering (HNG–31), (202) 472–7690, or Mr. Michael Laska, Office of the Chief Counsel (HCC–10), (202) 426–0762, Federal Highway Administration, 400 7th Street, SW., Washington, DC 20590. Office hours are from 7:45 a.m. to 4:15 p.m., ET, Monday through Friday, except legal holidays.

SUPPLEMENTARY INFORMATION: The FHWA's directive on bridge clearances for navigation (Federal-Aid Highway Program Manual 6–7–1–1–) has not been revised since 1971 although there have been changes in legislative requirements and project development procedures

EXHIBIT E

DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE
WASHINGTON

NOV 19 1985

REFER TO
CLA-2 CO:R:CV:V
553849 HS

Stephen L. Urbanczyk, Esq.
Williams and Connolly
839 Seventeenth Street, NW.
Washington, D.C. 20036

Dear Mr. Urbanczyk:

This is in response to the petition you filed with the Customs Service pursuant to section 516(a), Tariff Act of 1930, as amended (19 U.S.C. 1516(a)), on behalf of the National Corn Growers Association, New Energy Company of Indiana, Ohio Farm Bureau Federation, Inc., South Point Ethanol, and Archer Daniels Midland Company. The petition challenges Customs view that azeotropic distillation of up to 190 proof ethanol in a beneficiary country of the Caribbean Basin Initiative (CBI) program to 199+ proof ethanol makes the 199+ proof ethanol a product of the CBI beneficiary country entitled to duty-free treatment.

This response, written pursuant to 19 U.S.C. 1516(c) and 19 CFR 175.22(b), is to notify you that we have reviewed your petition, your additional submissions, and all other submissions received as the result of our notice published in the Federal Register on April 11, 1985, (50 F.R. 14250) and have determined that the Customs classification is correct.

Over 45 comments were submitted in response to the published notice. Many of these comments discussed policy issues regarding the Caribbean Basin Initiative. However, it is our view that there is only one controlling issue in this case: whether azeotropic distillation of 190 proof ethanol to 199+ proof ethanol is a substantial transformation.

It is argued by the petitioner and other commenters that the azeotropic distillation process neither creates a new or different article of commerce nor involves substantial processing.

A brief description of the azeotropic distillation process is as follows:

> At 190+ proof, ethanol will have formed an azeotrope with water and other impurities that must be removed before the ethanol can sucessfully be blended with gasoline to make gasohol. As an azeotrope is a

> constant boiling point liquid, traditional distillation processes are ineffective to break the azeotropic system. Thus, to produce ethanol suitable for blending to make gasohol, the azeotrope must be "cracked" using a Ternary Azeotropic Distillation process, whereby a third chemical is added to the ethanol solution to form a new mixture. This chemical is called an entrainer and is usually benzene, although cyclohexane, di-isopropyl ether, and gasoline have also been used. The entrainer forms a ternary azeotrope which is mainly water and benzene with a boiling temperature different from water. This temperature varies widely with the relative concentrations of ethanol, entrainer, and water. In addition, flow rates and pressures become critical control variables. Once the ternary azeotrope solution is separated from the ethanol, its vapors are condensed and sent to another distillation column to separate the benzene and trace amount of ethanol from the water.

Among the arguments set forth as to why 199+ proof ethanol is not a new and different article of commerce than ethanol of up to 190 proof are: (1) there is no chemical change between the 190 proof and 199+ proof alcohol -- the only difference is that water is removed; (2) there is no clear distinction between hydrous and anhydrous ethanol for many industrial uses; and (3) hydrous ethanol is used in Brazil as motor fuel.

It is Customs view that the extra 5 percent water that is missing from the anhydrous ethanol which causes the difference in specification is significant enough to make the anhydrous a new or different article of commerce. It is the absence of water that makes 200 proof ethanol suitable for particular uses, while it is the presence of water that makes 190 proof ethanol unsuitable for those same uses. Also, 190 and 200 proof ethanol have different freezing points, boiling points, densities, viscosities, vapor pressures and flash points.

Further evidence that 190 proof and 200 proof ethanol are different articles is the price differential between the two. For the past year, the Chemical Marketing Reporter has stated that the price of tax-free absolute ethanol is 12 cents per gallon higher than that of 190 proof tax-free ethanol. There is a price difference of about 8 percent. A price difference of about 5 percent is to be expected since the anhydrous product contains 5 percent more alcohol, but a price difference of 8 percent reflects, in part, the additional dehydration steps involved. By way of comparison, the price difference between two different grades of glycerine (99.5

percent and 96 percent) correlates almost exactly with the glycerine content of each, reflecting the fact that here the purer grade is subjected to a longer, but not a different, purification process.

Regarding the claim that 190 proof ethanol is used as motor fuel, the Brazilian government built a fleet of motor vehicles that used 190 proof ethanol as a defense against rising oil prices, but those vehicles and others like them were specially designed for that use. The modifications needed to enable the average car in the United States to use 190 proof ethanol would be more than minor and such vehicles are not commercially available in the United States.

In the United States, gasohol can have a maximum of 10 percent anhydrous ethanol according to EPA regulations. Only absolute ethanol can be blended with gasoline and technical references examined by Customs indicated that for ethanol to be blended with gasoline, to make gasohol, the entire fuel delivery system from refinery to tank trucks to underground tanks in filling stations, must be dry. Water, even a small amount, will "split" the blend, causing the blend to separate into an aqueous phase and a hydrocarbon phase. Accordingly, it is Customs view that anhydrous ethanol has a use in the United States -- for blending to make gasohol -- that hydrous ethanol will not serve. While hydrous and anhydrous ethanol may both serve some industrial uses, our research reveals that anhydrous ethanol even when used for industrial purposes is used generally for purposes where water cannot be tolerated, such as in certain chemical manufacturing processes and for certain solvents.

The arguments that azeotropic distillation is not a substantial processing operation are that (1) dehydration is merely the opposite of dilution and dilution is clearly not considered a sufficient operation to entitle an article to duty-free treatment pursuant to section 10.195, Customs Regulations; (2) azeotropic distillation is just a simple boiling and cooling procedure; (3) the process does not require many workers; (4) the incremental capital, energy and labor requirements are miniscule when compared with the total cost of converting agricultural feedstock to ethanol, and (5) there is no significant distinction between proof enrichment from 194-199+ and from 190-199+, and Customs has ruled that enrichment from 194-199+ would not be sufficient to entitle the ethanol to duty-free treatment.

It is Customs view that if removal of water were to be considered per se an operation not sufficient to entitle an article to duty-free treatment under the CBI, it could have been listed in the statute or regulations as easily as dilution was listed. Further, the addition of water to a product is generally a much more simple process than removing water.

Azeotropic distillation is more than a simple boiling and cooling procedure. The process involves complex equipment, sensitive instruments and trained personnel. In the particular operation challenged in this petition, the equipment includes a dehydration column over 150 feet high and 7 feet in diameter, over sixty stainless steel trays, each with nearly a hundred valves, plus weirs and downcomers, all manufactured to exacting standards. The Entrainer Recovery Column is 90 feet tall, 3 feet in diameter with nearly 60 stainless steel valve trays of its own. There are reboilers, heat exchangers, condensers, reflux tanks, decanters, surge tanks, vents, interconnecting piping, instrumentation, valves, pumps, meters, structure and mechanical systems required to maintain these columns.

In Uniroyal, Inc. v. United States, 542 F Supp. 1026, 3 CIT 220, aff'd 702 F2d 1022 (Fed Cir. 1983), the court stressed that factors such as cost and skill can be considered in determining whether a substantial transformation has occurred. In this case, the personnel must be trained to correctly monitor the azeotropic distillation process, and there has been an ample capital investment.

According to one comment, the drying process, per se, is not complex. Any complexity associated with the ternary distillation and directly associated process steps is in the design of the equipment and control apparatus. It is our view that the technical nature of the design of the equipment and the skill required of the workers to operate and monitor the system is of sufficient complexity to take the operation out of the simple combining, packaging or mere dilution categorization. While the number of workers involved in any specific operation is a factor to be considered in determining whether a substantial processing operation has occurred, it is not a controlling factor. In this particular case, we believe that the amount of local employment involved in the operation would not deter us from finding substantial processing.

We do not agree with the argument that the conversion of 190 proof ethanol to absolute ethanol is a minor step in the manufacture of ethanol from grain and therefore cannot be a substantial transformation. Obviously, the relative cost of any one step in an overall process will decrease as the number of steps increases. Further, each operation must be examined on its own as to whether it is a substantial transformation.

Finally, Customs holding in a General Headnote 3(a) case that there is not a substantial transformation when ethanol of 194 proof is brought up to 199+ proof through azeotropic distillation was based on the fact that an entire azeotropic distillation operation was not occurring in the insular possession. Customs looks at all operations on a case-by-case basis in determining whether substantial transformation occurs. In the particular case where an operation was proposed to make ethanol anhydrous from a level of 194 proof, it was Customs view that since a partial azeotropic distillation operation had already occurred, merely finishing the azeotropic distillation operation in the insular possession would not be sufficient to make the 199+ proof ethanol a product of that insular possession. In this instance an entire azeotropic distillation operation is occurring in the beneficiary country.

In summary, after reviewing the petition, supplemental submissions and all the comments received, Customs has decided to continue to consider the azeotropic distillation of up to 190 proof ethanol to 199+ proof ethanol in a beneficiary country of the Caribbean Basin Initiative a substantial transformation of the ethanol making the 199+ proof ethanol a new and different article of commerce entitled to duty-free treatment.

Sincerely,

Harvey B. Fox
Director, Classification
and Value Division

EXHIBIT E

taxpayer identifying number]". Specific instructions for the issuance and delivery of the [illegible], signed by the owner or [illegible]ntative, must accompany [illegible] presented. [illegible] in payment must be [illegible] at the expense and risk of the holder.

5.4. Registered definitive Notes will not be issued if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (e.g., an individual's social security number or an employer identification number) is not furnished. Delivery of the Notes in registered definitive form will be made after the requested form of registration has been validated, the registered interest account has been established, and the Notes have been inscribed.

6. General Provisions

6.1. As fiscal agents of the United States, Federal Reserve Banks are authorized, as directed by the Secretary of the Treasury, to receive tenders, to make allotments, to issue such notices as may be necessary, to receive payment for, to issue and deliver the Notes on full-paid allotments, and to maintain, service, and make payment on the Notes.

6.2. The Secretary of the Treasury may at any time supplement or amend provisions of this circular if such supplements or amendments do not adversely affect existing rights of holders of the Notes. Public announcement of such changes will be promptly provided.

6.3. The Notes issued under this circular shall be obligations of the United States, and, therefore, the faith of the United States Government is pledged to pay, in legal tender, principal and interest on the Notes.

Gerald Murphy,

Acting Fiscal Assistant Secretary.

[FR Doc. 86-1422 Filed 1-17-86; 2:10 pm]

BILLING CODE 4810-40-M

Customs Service

[T.D. 86-8]

Petitioners' Desire To Contest Decision Denying Domestic Interested Party Petition Requesting Reclassification of Certain Fuel Grade Ethanol

AGENCY: Customs Service, Treasury.

ACTION: Notice of petitioners' desire to contest decision on domestic interested party petition.

SUMMARY: This document advises the public of the desire of several domestic interested parties to contest Customs decision denying their petition requesting the reclassification of certain imported fuel grade ethanol. Customs has determined that the ethanol imported from several Caribbean Basin countries may qualify for duty-free entry under the Caribbean Basin Economic Recovery Act. The petitioners contend that the ethanol is incorrectly classified and they have advised Customs of their intention to pursue this matter through appropriate court proceedings.

DATE: January 22, 1986.

FOR FURTHER INFORMATION CONTACT: Harold Singer, Classification and Value Division, U.S. Customs Service, 1301 Constitution Avenue, NW., Washington, DC 20229 (202-566-2938).

SUPPLEMENTARY INFORMATION:

Background

On January 29, 1985, a petition was filed with Customs under section 516, Tariff Act of 1930, as amended (19 U.S.C. 1516), on behalf of several domestic interested parties dissatisfied with Customs determination that certain fuel grade ethanol imported from Caribbean Basin countries may qualify for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA; 19 U.S.C. 2701). The product at issue, ethyl alcohol (ethanol) imported for use as a fuel, is classified under item 901.50, Tariff Schedules of the United States (TSUS; 19 U.S.C. 1202), at a rate of duty of 60¢ per gallon. (This 60¢ per gallon duty is in addition to a 3% ad valorem duty on ethanol for nonbeverage purposes from item 427.88, TSUS). However, some ethanol may enter the U.S. free of duty since Customs has ruled that the transformation of beverage grade ethanol from a non-beneficiary country to motor fuel ethanol in a beneficiary country through azeotropic distillation is sufficient to make the motor fuel a product of the beneficiary country for purposes of the CBERA.

The domestic interested parties advanced two basic arguments in their petition. First, it was argued that fuel grade ethanol is not a new or different article of commerce from beverage grade ethanol as the only significant difference in the composition of the two is their water content. It was also contended that the azeotropic method of distillation, which involves adding benzene or some other chemical to 190 proof ethanol and then heating the mixture so that the benzene will vaporize and carry away most or all of the water, is not a substantial manufacturing process.

A notice of receipt of the petition was published in the Federal Register on April 11, 1985 (50 FR 14250), advising the public of the petitioners' contentions and requesting comments on the petition. Of the many comments received in response to the notice, numerous commenters chose to discuss policy issues concerning the Caribbean Basin Initiative. However, it is Customs view that there is only one controlling issue in this case: whether azeotropic distillation of 190 proof ethanol to 199+ proof ethanol is a substantial transformation.

Discussion of Comments

The arguments that azeotropic distillation is not a substantial processing operation are that (1) dehydration is merely the opposite of dilution and dilution is clearly not considered a sufficient operation to entitle an article to duty-free treatment pursuant to § 10.195, Customs Regulations (19 CFR 10.195); (2) azeotropic distillation is just a simple boiling and cooling procedure; (3) the process does not require many workers; (4) the incremental capital, energy and labor requirements are miniscule when compared with the total cost of converting agricultural feedstock to ethanol, and (5) there is no significant distinction between proof enrichment from 194-199+ and from 190-199+, and Customs has ruled that enrichment from 194-199+ would not be sufficient to entitle the ethanol to duty-free treatment.

It is Customs view that if removal of water were to be considered *per se* as an operation not sufficient to entitle an article to duty-free treatment under the CBI, it could have been listed in the statute or regulations as easily as dilution was listed. Further, the addition of water to a product is generally a much more simple process than removing water.

Azeotropic distillation is more than a simple boiling and cooling procedure. The process involves complex equipment, sensitive instruments and trained personnel; in the particular operation challenged in this petition, the equipment includes a dehydration column over 150 feet high and 7 feet in diameter, over 60 stainless steel trays, each with nearly 100 valves, plus weirs and downcomers, all manufactured to exacting standards. The Entrainer [illegible] Recovery Column is 60 feet tall, [illegible] feet in diameter with nearly 60 stainless steel [illegible] valve trays of its own. There are [illegible] reboilers, heat exchangers, [illegible] reflux tanks, decanters, surge tanks, [illegible] vents, pumps, motors, structure and [illegible] mechanical systems required to maintain these columns.

In *Uniroyal, Inc. v. United States*, 542 F Supp. 1026, 3 CIT 220, *aff'd* 702 F2d 1022 (Fed Cir. 1983), the court stressed that factors such as cost and skill can be considered in determining whether a substantial transformation has occurred. In this case, the personnel must be trained to correctly monitor the azeotropic distillation process, and there has been an ample capital investment.

According to one comment, the drying process, *per se*, is not complex. Any complexity associated with the ternary distillation and directly associated process steps is in the design of the equipment and control apparatus. It is our view that the technical nature of the design of the equipment and the skill required of the workers to operate and monitor the system is of sufficient complexity to take the operation out of the simple combining, packaging or mere dilution categorization. While the number of workers involved in any specific operation is a factor to be considered in determining whether a substantial processing operation has occurred, it is not a controlling factor. In this particular case, we believe that the amount of local employment involved in the operation would not deter us from finding substantial processing.

We do not agree with the argument that the conversion of 190 proof ethanol to absolute ethanol is a minor step in the manufacture of ethanol from grain and therefore cannot be a substantial transformation. Obviously, the relative cost of any one step in an overall process will decrease as the number of steps increases. Further, each operation must be examined on its own as to whether it is a substantial transformation.

Finally, Customs holding in a General Headnote 3(a) case (19 U.S.C. 1202) that there is not a substantial transformation when ethanol of 194 proof is brought up to 199+ proof through azeotropic distillation was based on the fact that an entire azeotropic distillation operation was not occurring in the insular possession. Customs looks at all operations on a case-by-case basis in determining whether substantial transformation occurs. In the particular case where an operation was proposed to make ethanol anhydrous from a level of 194 proof, it was Customs view that since a partial azeotropic distillation operation had already occurred, merely finishing the azeotropic distillation operation in the insular possession would not be sufficient to make the 199+ proof ethanol a product of that insular possession. In this instance an entire azeotropic distillation operation is occurring in the beneficiary country.

Among the arguments set forth as to why 199+ proof ethanol is not a new and differing article of commerce than ethanol of up to 190 proof are: (1) There is no chemical change between the 190 proof and 199+ proof alcohol—the only difference is that water is removed; (2) there is no clear distinction between hydrous and anhydrous ethanol for many industrial uses; and (3) hydrous ethanol is used in Brazil as motor fuel.

It is Customs view that the extra 5 percent water that is missing from the anhydrous ethanol which causes the difference in specification is significant enough to make the anhydrous a new or different article of commerce. It is the absence of water that makes 200 proof ethanol suitable for particular uses, while it is the presence of water that makes 190 proof ethanol unsuitable for those same uses. Also, 190 and 200 proof ethanol have different freezing points, boiling points, densities, viscosities, vapor pressures and flash points.

Further evidence that 190 proof and 200 proof ethanol are different articles is the price differential between the two. For the past year, the *Chemical Marketing Reporter* has stated that the price of tax-free absolute ethanol is 12 cents per gallon higher than that of 190 proof tax-free ethanol. There is a price difference of about 8 percent. A price difference of about 5 percent is to be expected since the anhydrous product contains 5 percent more alcohol, but a price difference of 8 percent reflects, in part, the additional dehydration steps involved.

Regarding the claim that 190 proof ethanol is used as motor fuel, the Brazilian government built a fleet of motor vehicles that used 190 proof ethanol as a defense against rising oil prices, but those vehicles and others like them were specially designed for that use. The modifications needed to enable the average car in the U.S. to use 190 proof ethanol would be more than minor and such vehicles are not commercially available in the U.S.

In the U.S., gasohol can have a maximum of 10 percent anhydrous ethanol according to EPA regulations (see 47 FR 14596, April 5, 1982). Only absolute ethanol can be blended with gasoline and technical references examined by Customs indicated that for ethanol to be blended with gasoline, to make gasohol, the entire fuel delivery system from refinery to tank trucks to underground tanks in filling stations, must be dry. Water, even a small amount, will "split" the blend, causing the blend to separate into an aqueous phase and a hydrocarbon phase. Accordingly, it is Cutoms view that anhydrous ethanol has a use in the U.S., for blending to make gasohol, that hydrous ethanol will not serve. While hydrous and anhydrous ethanol may both serve some industrial uses, our research reveals that anhydrous ethanol even when used for industrial purposes is used generally for purposes where water cannot be tolerated, such as in certain manufacturing processes and for certain solvents.

Decision on Petition and Notice of Petitioners' Desire to Contest

After careful analysis of the petition, supplemental submissions, and all comments received, Customs has decided to continue to consider the azeotropic distillation of up to 190 proof ethanol to 199+ proof ethanol in a beneficiary country of the Caribbean Basin Initiative a substantial transformation of the ethanol making the 199+ proof ethanol a new and different article of commerce entitled to duty-free entry. The petitioners were informed by letter dated November 19, 1985 (CLA-2 CO:R:CV:V 553849 HS), through their counsel, that Customs is of the opinion that the current classification is correct and their petition is therefore denied.

In response to Customs decision to deny the petition, on November 19, 1985, the petitioners filed notice of their intention to contest the decision in accordance with section 516(c), Tariff Act of 1930, as amended (19 U.S.C. 1516(c)), and § 175.23 Customs Regulations (19 CFR 175.23).

Customs has reconsidered the matter in light of the petitioners' letter, but remains of the opinion that its November 19, 1985, decision is correct. That decision will stand in the absence of a contrary judgment rendered by the U.S. Court of International Trade or the U.S. Court of Appeals for the Federal Circuit.

Authority

This notice is published under the authority of section 516(c), Tariff Act of 1930, as amended (19 U.S.C. 1516(c)), and § 175.24, Customs Regulations (19 CFR 175.24).

Drafting Information

The principal author of this document was John E. Doyle, Office Regulations and Rulings, U.S. Customs Service. However, personnel from other Customs offices participated in its development.

John P. Simpson,
Acting Commissioner of Customs.

Approved January 7, 1986.

Francis A. Keating, II,
Assistant Secretary of the Treasury.

[FR Doc. 86-1330 Filed 1-21-86; 8:45 am]

BILLING CODE 4820-02-M

Chairman GIBBONS. That may answer a lot of questions about it. Because it is obvious that you apparently had to give it a lot of consideration. Or is this matter relatively routine? Is this the first one in the Caribbean we have had of this sort?

Mr. FOX. This matter was given a lot of consideration. I believe this ruling was the first azeotropic distillation in the CBI.

Chairman GIBBONS. I am talking about just general rulings. When did we pass the CBI? It was in 1984, wasn't it? 1983, we finally passed it in 1983? Was this the first substantial ruling that you had?

Mr. FOX. No, we have issued many others, CBI rulings.

Chairman GIBBONS. Well, I am sensitive—as I said before, because of the problem I have with orange juice and the substantial transformation of concentrate—about taking out the water and shooting the water back.

As far as I know, it is not nearly as complicated a process as taking out this 5 percent. And clearly it was my intention of CBI law, just taking water in and out of orange concentration was not a substantial transformation.

Mr. FOX. Mere dilutions with water are specifically preceded by the statute.

Chairman GIBBONS. I may have confused in my own mind the process of taking out that 5 percent water here. I really don't know yet whether that is a substantial transformation in my own mind, that 5 percent. But it has more credence after what you have described here than it did before I came into this hearing this morning.

Mr. Frenzel.

Mr. FRENZEL. Mr. Chairman, I have no other questions. Thank you.

Chairman GIBBONS. Do any of the other agencies wish to add anything at this time? You are wise to keep your mouth shut.

All right. Well, this will conclude the hearings on miscellaneous tariff and trade bills. The record on these bills will remain open until the close of business Thursday, February 13, 1986, and if anybody knows why any of these bills should not pass, I wish they would please let us know. Thank you very much.

[Whereupon, at 12:35 p.m., the hearing was adjourned subject to the call of the Chair.]

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APPENDIX

SUBMISSIONS FOR THE RECORD

The following submissions are listed in numerical order by bill number, except in cases where respondents commented on more than one bill; those bills have been grouped by subject.

H.R. 839

Relating to the marking of containers of imported mushrooms.

STATEMENT OF HENRY J. VOSS, PRESIDENT
CALIFORNIA FARM BUREAU FEDERATION

The California Farm Bureau Federation (CFBF) welcomes the opportunity to comment on a number of tariff and trade bills coming before the Subcommittee. CFBF represents roughly 85% of the farmers in the state involved in the production of over 200 different commodities. As a general farm organization, CFBF represents the interests of all agriculture and is especially concerned with trade actions that affect the farm community.

The following are our comments on certain bills relating to agricultural trade.

Customs and Other Nontariff Bills

H.R. 839. Relating to the marking of containers of imported mushrooms. Farm Bureau supports measures requiring all imported agricultural products to be labeled as to country of origin. Therefore, we support H.R. 839.

H.R. 1567. To exclude from the Caribbean Basin Economic Recovery Act ethyl alcohol used for fuel which is merely distilled or denatured in a beneficiary country. Under current circumstances, the intent of the Caribbean Basin Economic Recovery Act is being violated by third countries wishing to circumvent the 60 cent per gallon duty on ethyl alcohol imported to the U.S. This practice is damaging both to domestic corn producers and to government programs directed at improving farm income and stabilizing the agricultural economy. Farm Bureau supports H.R. 1567.

H.R. 1720. To ensure payment of the regular duties imposed on imported ethyl alcohol and payment of the additional duty imposed on ethyl alcohol when imported for use in producing a mixture of gasoline and alcohol or used otherwise as fuel. Existing duties on imported ethyl alcohol are important to the economic stability of domestic grain producers as well as members of the developing U.S. industry of fuel production. It is important that these duties be enforced. Farm Bureau supports H.R. 1720.

H.R. 1566. To ensure payment of the additional duty imposed on ethyl alcohol used as a fuel or in making gasohol. Farm Bureau supports H.R. 1566 for the reasons noted above.

International trade is essential to California's agricultural economy. We appreciate your consideration of our views on these bills.

Insecticide Residues in Imported Canned Mushrooms
Pertaining to HR 839

Clifford B. Keil, Ph.D.
Assistant Professor of Entomology
University of Delaware

February 10, 1986

Congressman Schulze's bill, HR 839, pertaining to labelling containers of imported preserved (canned) mushrooms as to country of origin is a timely and important piece of legislation promoting consumer awareness. Insect parts and other filth can be important and highly visible contaminants of canned mushrooms, reflecting both a lax regulatory environment and unsanitary packing procedures in importing countries. Macroscopic filth of this nature can be easily detected by inspection. My concern is for a more insidious class of contamination - pesticide residues.

Pesticide applications by mushroom growers in the United States are strictly regulated by the Environmental Protection Agency. Presently, only two effective compounds with significant vertebrate toxicity can be applied in mushroom houses when there is active mycelia present; permethrin for fly control and zineb for control of fungal pathogens. Neither compound can be legally applied when mushrooms are present. In contrast, foreign producers of mushrooms are largely unregulated and have access to a plethora of pesticides. Many of these compounds have lost their U.S. registrations or have very restricted registrations for non-food commodities because of extreme vertebrate toxicity or persistence.

The Food and Drug Administration is charged with the certification of wholesomeness of imported food products, including mushrooms. The detection of pesticide residues in canned products is almost an impossible task without having a target suspect pesticide. There are well over 200 possible compounds to search for and each group of pesticides must be extracted from the product and analyzed with a unique protocol. Further, the volume of imported mushrooms, 100 million pounds annually, makes intensive monitoring impractical.

The Natural Resources Defense Council published a report in 1984 entitled, "Harvest of Unknowns - Pesticide Contamination in Imported Foods". This report documented the presence of illegal pesticide residues in imported fresh foods, particularly coffee. There is every reason to believe that the residue problem is similar in canned mushrooms and other produce.

The exposure to moisture and heat of the canning process will, in all likelihood, degrade and detoxify a number of pesticides although small residues may still remain. I am particularly concerned about the presence of one class of insecticides that are chemically resistant to degradation during the canning process, organochlorines. Insecticides in this class include; DDT, chlordane, endrin, aldrin, and lindane, all of which are illegal for use on food products in the United States. These compounds are persistent, bioaccumulative and have largely undetermined long range toxic effects. Lindane is of particular concern in imported canned mushrooms. Lindane is used extensively in many Asian countries for control of insects in rice paddies. Rice straw is used to make mushroom compost and in all likelihood retains significant amounts of lindane. The compound can be incorporated into the growing mycelia and mushroom from the compost. Lindane may also be used for fly control in and around mushroom farms. Lindane is carcinogenic. Related compounds have been linked with increased incidence of spontaneous abortion. There is a zero tolerance for this material in food stuffs.

Congressman Schulze's bill (HR 839) provides a short term solution to this problem by providing consumers with a means to make a decision regarding the wholesomeness of the food they purchase. We have decided as a society that pesticides applied to food items will be investigated, registered, and regulated for our health and well-being. The costs to taxpayers for these actions is high both in terms of the regulatory process itself and the higher costs of food production through restricted pest control options. American consumers deserve to know which mushroom products are grown under the strict guidelines of domestic agriculture and hence free of unreasonable and unhealthful pesticide residues and which are grown in unregulated and potentially dangerous situations abroad.

cc

national grange

1616 H STREET, N.W. WASHINGTON, D.C. 20006 (202) 628-3507

Edward Andersen, Master

February 6, 1986

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Ways and Means
Subcommittee on Trade

The Honorable Sam M. Gibbons, Chairman
Subcommittee on Trade
House Ways & Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The National Grange, an agricultural trade association representing over 400,000 members in 41 states, supports measures requiring that all imported agricultural products be labeled as to country of origin. Therefore, we support **H.R. 839,** which is currently pending before your Trade Subcommittee.

H.R. 839 will amend the 1930 Tariff Act to require **containers of imported processed mushrooms to have label identification of the country where the mushrooms were grown.** This would amount to a minor, but significant, change in current law that merely requires identification of the nation of last processing. H.R. 839 would neither impose protectionist barriers against foreign trading partners nor mandate excessive, unreasonable labeling standards.

The Grange believes that the labeling provisions of H.R. 839 are completely justified for ensuring the disclosure of pertinent information to America's consuming public. Indeed, without the information mandated by H.R. 839, unsuspecting American consumers would be misled into the potentially harmful belief that their canned mushrooms were grown under America's rigorous health and safety standards. We further believe that consumers have the right to know whether or not the mushrooms that are canned by American processors were also grown in accordance to American standards.

The National Grange is convinced that enactment of H.R. 839 is necessary if the American consumers are to have the assurance that the processed mushrooms they purchase have been grown as well as processed under high U.S. health and sanitation standards.

For these reasons, we sincerely request favorable action on H.R. 839 as soon as possible. Thank you.

Sincerely,

Edward Andersen
Edward Andersen, Master

EA/pkh

ccc

Pennsylvania State Grange

1604 North Second Street
Harrisburg, Pennsylvania 17102
(717) 234-5001

RECEIVED
FEB - 3 1986
Ways and Means
Subcommittee on Trade

January 31, 1986

The Honorable Sam M. Gibbons
Subcommittee on Trade, House Ways & Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Congressman Gibbons,

The Pennsylvania State Grange, representing 42,000 rural Pennsylvanians, supports HR 839, which is currently in your Committee. This legislation requires that containers of imported mushrooms be labelled in English as to their country of origin.

Mushroom imports have increased drastically over the past several years. As a result domestic growers have suffered financially. Currently, U.S. citizens have no way of determining where the mushrooms they buy are grown. This legislation will give consumers the option of choosing a domestic or foreign brand.

Congressman Gibbons, we are hopeful that you will agree with our decision and that the House Ways and Means Subcommittee on Trade will vote positively on HR 839.

Thank you for your consideration on this matter. We would like this letter to become part of the record on HR 839.

Sincerely,

Brenda J. Shambaugh

Brenda J. Shambaugh
Legislative Director

cc: The Honorable Richard Schulze
National Grange

FAMILY FARM ORGANIZATION SERVING RURAL PENNSYLVANIA

H.R. 1004

To amend the National Traffic and Motor Vehicle Safety Act of 1966 to establish procedures under which any person may petition for an investigation (including testing and inspection) regarding any automobile manufacturer's certification of compliance with vehicle safety standards, and to permit suspension of importation of vehicles pending the outcome of such investigation.

MEMORANDUM

AUTOMOBILE IMPORTERS OF AMERICA, INC.

Automobile Importers of America, Inc. (AIA) is an association of most major importers of automobiles. Our 19 member companies (11 Europeans and 8 Japanese) unanimously oppose H.R. 1004 as both bad automotive policy and bad trade policy.

H.R. 1004 would amend the National Traffic and Motor Vehicle Safety Act of 1966 by adding a statutory mechanism to allow any person to petition the Secretary of Transportation (the Secretary) requesting an investigation of any manufacturer's certification of compliance with U.S. motor vehicle safety standards. In addition, H.R. 1004 would authorize the Secretary to "refuse admission to the United States" or "introduction into interstate commerce [of] any motor vehicle or item of motor vehicle equipment covered by ... certification during the pendency" of the investigation. (Emphasis added.)

AIA opposes H.R. 1004 because, if enacted, it would place an unnecessary and redundant regulatory burden on manufacturers, both foreign and domestic, and the Department of Transportation (DOT). It would not increase the present substantive authority of the DOT to protect the public against motor vehicles not in compliance with U.S. safety standards, but would merely permit the Secretary to deny foreign and domestic automobile manufacturers access to interstate commerce upon the initiation of any investigation -- before any determination of non-compliance.

The present statute gives the Secretary authority to suspend importation of automobiles which do not meet U.S. safety standards:

(a)(1) No person shall -

> (A) manufacture for sale, sell, offer for sale, or introduce or deliver for introduction in interstate commerce, or import into the United States, any motor vehicle or item of motor vehicle equipment ... unless it is in conformity with ... [any applicable Federal motor vehicle standard];
>
> ....

> (C) fail to issue a certificate ... to the effect that a motor vehicle or item of motor vehicle equipment conforms to all applicable Federal motor vehicle safety standards...;
>
> ....
>
> (b)(3) A motor vehicle or item of motor vehicle equipment offered for importation in violation of paragraph (1)(A) of subsection (a) of this section shall be refused admission into the United States under joint regulations issued by the Secretary of the Treasury and the Secretary [of Transportation].

15 U.S.C. §1397 (emphasis added).

In addition, under existing regulations any person can petition the Administrator of the National Highway Traffic Safety Administration (NHTSA), the Secretary's authorized representative with respect to vehicle safety issues, to determine whether a vehicle complies with applicable safety standards. The only requirement for such petition is that it be in English setting forth the facts and describing the proposed remedy. Title 49 of the Code of Federal Regulations provides:

> Section 552.1 Scope -
>
> This part establishes procedures for the submission and disposition of petitions filed by interested persons pursuant to the National Traffic and Motor Vehicle Safety Act ... to make a determination that a motor vehicle ... does not comply with an applicable Federal motor vehicle safety standard.
>
> ....
>
> Section 552.3 General -
>
> Any interested person may file with the Administrator a petition requesting him ... (b) to commence a proceeding to determine whether to issue an order concerning the notification and remedy of a failure of a motor vehicle ... to comply with an applicable motor vehicle safety standard.
>
> ....
>
> Section 554.11 Final determinations -
>
> ....
>
> (b) If the Administrator determines that a failure to comply ... exists, he orders the manufacturer ... to remedy the defect or failure to comply.

With respect to imports, Title 19 of the Code of Federal Regulations provides:

> Section 12.80 Federal motor vehicle safety standards
>
> (a) ... A motor vehicle ... or item of motor vehicle equipment ... is not permitted entry into the Customs territory of the United States unless ... it is in conformity with applicable safety standards....

From the above, it is clear that ample present authority exists to exclude from U.S. interstate and foreign commerce any vehicle or item of vehicle equipment that is found, after a determination by the NHTSA, to be not in compliance with safety regulations and improperly certified by its manufacturer.

H. R. 1004's only addition to present law would be to permit exclusion before such a determination, i.e., simply on the basis of the granting of a request of "any person" for "an investigation with respect to such certification." Such an arbitrary denial of the due process of law would probably be unconstitutional. In effect, H.R. 1004 would put the cart before the horse. The decision to exclude would take place before any administrative or judicial procedure to determine the merits of the exclusion.

In short, H. R. 1004 would merely repeat the substantive provisions of present law permitting exclusion of improperly certified vehicles but would permit such exclusion before, rather than after, any judicial or administrative proceeding to determine the facts. AIA strongly opposes H.R. 1004.

STATEMENT OF THE INTERNATIONAL UNION, UAW TO THE SUBCOMMITTEE ON TRADE OF THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES ON H.R. 1004 - AMENDMENTS TO THE NATIONAL TRAFFIC AND MOTOR VEHICLE SAFETY ACT OF 1966

The UAW has long been a strong supporter of increased auto safety. There are few products which are so widely used by our citizens for which compliance with safety standards is so important. We believe that guaranteeing the safety of vehicles sold in this country is an essential function of our government. The current practice of accepting the certification made by auto manufacturers that their products meet the standards established by the National Traffic and Motor Vehicle Safety Act of 1966 must, therefore, be reviewed to assure that our citizens are being adequately protected.

Because imported cars have become a much larger share of those on our roads, their compliance with U.S. safety requirements has become a greater concern. With the production of these vehicles beyond our shores, assuring compliance becomes more difficult. H.R. 1004 addresses the need to protect the public from imported cars which may be incorrectly certified as meeting safety standards.

There is another important consideration in assessing the treatment of imported vehicles and their safety certifications. Several countries, but especially Japan, have used excessive safety certification requirements on imports to discourage foreign vehicle producers from sending exports and to raise the price of those exports due to the additional testing needed to show safety compliance. The Japanese have used this procedure for many years.

The lopsided trade in automobiles between the U.S. and Japan, which is well known and well documented, is partly due to this disparity in treatment at our respective borders. The U.S. trade deficit with Japan in fully-assembled cars reached $17 billion in 1985, up from an already high $13 billion in 1984, according to figures recently released by the U.S. Commerce Department. The U.S. trade deficit in autos with all other countries was $14 billion in 1985.

The amendments to the National Traffic and Motor Vehicle Safety Act of 1966 contained in H.R. 1004 would permit any person to question the validity of a manufacturer's safety certification to the Secretary of Transportation. If the Secretary determines that there is reason to investigate the certification, a hearing must be held and testing and inspection may be required. The bill would allow the Secretary, during the course of the investigation, to refuse entry into the U.S. of imported vehicles covered by the certification. We believe this authority is necessary to protect the safety of all those who use the nation's roads. Similarly, the Secretary could prevent delivery of domestically produced cars into interstate commerce during a certification investigation. Thus, there is no discrimination against imports in these amendments.

The UAW supports H.R. 1004. Its passage would assure increased compliance with our safety requirements and give the Transportation Department the necessary authority to prevent vehicles suspected of being unsafe from endangering our citizens. This bill also makes clear that our trading partners who use safety certification to limit U.S. exports of cars, among other products, can be subject to the same treatment of their exports to the U.S.

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MVMA STATEMENT ON H.R. 1004

The Motor Vehicle Manufacturers Association (MVMA)* and its member companies appreciate the opportunity to comment on H.R. 1004, legislation which was introduced on February 6, 1985 by Representative Don Pease (D-OH).

This legislation would add a new procedure requiring the Secretary of Transportation to examine the validity of a motor vehicle manufacturer's certification of its products under provisions of the National Traffic and Motor Vehicle Safety Act of 1966. Such an inquiry would be initiated by the filing of a petition by any person or organization, at any time, for any reason. The Secretary could then decide to conduct a formal investigation to determine the validity of the manufacturer's certification. This new petition procedure would be available with respect to the manufacture of all new motor vehicles sold in the U.S., whether domestic or foreign. While such an investigation is underway, affected foreign vehicles may be refused admission to the United States and all affected vehicles, both foreign and domestic, could be restricted from interstate commerce.

MVMA has a number of objections to the broad and expansive scope of the authorities contained in H.R. 1004.

First, H.R. 1004 would create a regulatory process which is unnecessary and in many respects duplicative. The Safety Act presently provides that "no person shall manufacture for sale, or introduce or deliver for introduction in interstate commerce, or import into the United States, any motor vehicle ... manufactured on or after the date any applicable Federal motor vehicle safety standard takes effect ... unless it is in conformity with such standard." The Act further provides for defect and non-compliance investigative procedures.

The vast majority of vehicle safety recalls are initiated by manufacturers entirely on their own and in response to applicable laws and regulations. Furthermore, the National Highway Traffic Safety Administration performs compliance testing and also has in place within its enforcement group the process for collecting and reviewing private citizen complaints regarding motor vehicle safety performance. The agency maintains a "hot line" to receive questions and complaints by telephone. Contacts received through these activities are monitored and assessed to determine the need for formal action by the agency. This current process is much more efficient for identifying and addressing real safety problems than one which would require an individual, formal review and response for each petition.

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* MVMA represents U.S. automobile, truck and bus manufacturers producing nearly 99 percent of all domestic motor vehicles. MVMA members include: American Motors Corporation; AM General Corporation; Chrysler Corporation; Ford Motor Company; General Motors Corporation; Honda of America Mfg., Inc.; International Harvester Company; M.A.N. Truck & Bus Corporation; PACCAR Inc; Volkswagen of America, Inc.; and Volvo North America Corporation.

Second, the DOT would be empowered to certify the safety of all vehicles sold in the U.S. rather than the manufacturer under our current system of self certification. On a more general level, the entire safety rulemaking and certification process would become subject to petitions of whim or harrassment, and an open invitation to disrupt, for any purpose, the process by which the U.S. government has established and confirmed compliance with safety standards for automobiles and trucks sold in the United States.

Third, it is unclear from the language of this bill precisely what the intended purpose is. On initial reading, it would appear that the target of the bill's attention is the validity of the rulemaking and compliance structure which implements the National Traffic and Motor Vehicle Safety Act of 1966. However, according to the statement released by Rep. Pease at the time of the introduction of H.R. 1004, the bill's objectives concern the desire for reciprocity by the Japanese government to permit new U.S. made motor vehicles entering Japan to be certified in the same manner that Japanese vehicles entering the U.S. market are. It is not at all clear how this new petition procedure would achieve the apparent purpose of H.R. 1004. There is also no assertion made by the author of the bill that Japanese vehicles imported into the U.S. are having certication problems.

Fourth, MVMA would like to emphasize that the bill's sweeping authorization of power could, at a stroke, stop the sale of all autos or trucks of a particular model by any manufacturer, foreign or domestic, throughout the United States, for an indefinite period of time even before it was known whether there was any reason to believe that the vehicles were not in compliance. While some may argue that such sweeping power would not be used capriciously or haphazardly, we wish to observe that it is to prevent the abuse of such power that Congress has traditionally exercised extreme caution in enacting any such broad, categorical delegations of power into law.

Fifth, the bill sets no criteria regarding the appropriateness, credibility or relevance of a person or organization to initiate such petitions, and thereby cause the massive disruption in production and marketing by companies which could result. For example, such a petition procedure could be inappropriately used as a competitive tool, to disadvantage one manufacturer over another. The application of the petitioning authority to initiate such major investigations is so broad that at best, it could be a major nuisance, and at worse, a major threat to the competitivess of a manufacturer.

Finally, MVMA believes that, with such a statute enacted, even if the Secretary chose not to initiate any such investigations, the repeated filing of such petitions, for whatever reasons, would create an atmosphere which could seriously erode the confidence of the American consumer in the U.S. safety regulatory and manufacturer certification process. Also, it would divert agency resources from valid safety matters.

The U.S. motor vehicle industry has worked for decades to produce safe vehicles for the driving public. We believe this bill would detract from our efforts to continously improve that record. Therefore, MVMA, while it appreciates the sponsor's interest, strongly opposes H.R. 1004.

H.R. 1566

To ensure payment of additional duty imposed on ethyl alcohol used as a fuel or in making gasohol.

H.R. 1567

To exclude from the Caribbean Basin Economic Recovery Act ethyl alcohol used for fuel which is merely distilled or denatured in a beneficiary country.

H.R. 1720

To ensure payment of the regular duties imposed on imported ethyl alcohol and payment of the additional duty imposed on ethyl alcohol when imported for use in producing a mixture of gasoline and alcohol or used otherwise as fuel.

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8400

C. E. Sandler
Vice President

February 12, 1986

The Honorable
Sam M. Gibbons
Chairman
Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On February 6 and 7, the House Ways and Means Subcommittee on Trade held a hearing on various tariff and trade bills, including several regarding the tariff treatment of gasoline blendstocks and ethanol imported for fuel use. Since API's members produce and market a full range of petroleum products, including gasoline and, in some cases, gasohol, we have a significant interest in any legislation affecting the tariff classification of motor fuel, motor fuel blendstocks, naphthas and ethanol.

As you know, we submitted comments last year on H.R.2354, H.R.2396, H.R.1566, H.R.1567, and H.R.1720. Those comments are attached and we respectfully request that they be made part of the record associated with the hearings held last week.

API continues to support creating a new category for motor fuel blendstocks in the Tariff Schedules of the United States, with a duty rate at least equal to that of motor fuel. Also, API believes that fuel grade ethanol imported into the U.S. should bear the 60 cents per gallon duty mandated by Congress. The tariff treatment of fuel grade ethanol is of particular concern in light of the Customs Service's November 19, 1985 reaffirmation of their determination that hydrous alcohol imported into a Caribbean Basin country and dehydrated through azeotropic distillation undergoes a substantial transformation and can therefore enter the U.S. duty-free under the Caribbean Basin Economic Recovery Act.

API appreciates the opportunity to comment on this legislation. If you have any questions, please contact Ed Beck in API's Federal Relations Department at 682-8418.

Sincerely,

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American Petroleum Institute
1220 L Street Northwest
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Charles J DiBona
President

June 28, 1985

The Honorable
Sam M. Gibbons
Chairman
Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

The American Petroleum Institute (API) is pleased to respond to the House Ways and Means Subcommittee on Trade's request for comments on miscellaneous tariff and trade bills. API will comment on H.R. 2354 and H.R. 2396 concerning the tariff treatment of motor fuel, motor fuel blendstocks and naphthas; and H.R. 1566, H.R. 1567 and H.R. 1720 pertaining to ethanol imports. API is a trade association of 230 companies and 6000 individual members who are engaged in all aspects of the petroleum industry including exploration, production, transportation, refining and marketing. Since API's members produce and market a full range of products including both gasoline and gasohol, API and its members have a direct and substantial interest in any legislation which affects the tariff classification of motor fuel, motor fuel blendstocks, naphthas and ethanol.

API supports creating a new category for motor fuel blendstocks in the Tariff Schedules of the United States (TSUS), with a duty rate at least equal to that of motor fuel. In addition, API believes that ethanol imports should not be allowed to enter the United States without being subject to the 60 cents per gallon duty mandated by Congress.

Motor Fuel Blending Stocks: H.R. 2354 and H.R. 2396

Both of these bills strive to clarify the treatment of motor fuel blending stocks in the TSUS. H.R. 2354 would specifically include these blendstocks in the line item for gasoline and raise the present tariff, while H.R. 2396 would create a separate listing for motor fuel blendstocks and duty them at the current motor fuel rate of 1.25 cents per gallon.

Because the present tariff schedule does not include a separate listing for motor fuel blendstocks, they have been assessed at a range of different tariffs by Customs officials in various ports of entry. This situation has been further complicated by Treasury Decision 83-173, which adopted updated ASTM specifications (D 439-83) for motor fuel and resulted in naphthas with a combined octane rating below 85 for unleaded or below 87 for leaded no longer being defined as motor fuels. Thus, while certain Customs officials assessed cargoes of these blendstocks at the motor fuel tariff rate (1.25 cents per gallon), others dutied them at the lower naphtha rate (.25 cents per gallon), and still others at a higher ad valorem rate.

API believes that the confusion and uncertainty this has caused can be clarified through legislation which would create a new motor fuel blendstock tariff category. As API has stated in previous comments to the International Trade Commission (ITC), we support the creation of a motor fuel blendstock category to be dutied at a rate no lower than the motor fuel rate. As recommended in the April, 1985 ITC report on the tariff classification of catalytic naphtha and other motor fuel blendstocks, this category should be based on the actual end-use of the material, i.e. whether it is blended directly with gasoline or subject to further processing. A tariff rate for blendstocks at least equal to the motor fuel rate is necessary to prevent high-value, high-octane petroleum products, such as catalytic naphtha or reformate, from being imported at the lower duty set for naphthas. Since this material is the result of catalytic processing and is blended directly in gasoline to increase the octane level, it is significantly different from "virgin" naphtha. Any legislation should clearly make this distinction between naphthas used directly as blendstocks in gasoline, and virgin naphthas and petrochemical feedstocks which do require further processing and therefore should receive a lower tariff.

While this new blendstock category should be defined to include those fuel components which are capable of being blended directly into gasoline without further processing, ethanol and gasoline/ethanol blends should be explicitly excluded from this new category. As will be further discussed below, imports of ethanol and gasoline/ethanol blends should not circumvent the special 60 cents per gallon duty Congress mandated for fuel ethanol imports. As written, both H.R. 2354 and H.R. 2396 could allow ethanol and gasoline/ethanol blends to enter as "blending stocks" without the 60 cent duty.

Ethanol Imports: H.R. 1566, H.R. 1567 and H.R. 1720

API is pleased that legislation has been introduced to address the problem of ethanol imports circumventing the 60 cents per gallon tariff. API is, and has been, concerned that there are a variety of means by which ethanol imports can avoid the 60 cent tariff.* The above referenced ethanol legislation eliminates some, but not all, of those means.

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* See attached API comments to the U.S. Customs Service, June 13, 1985.

One way which ethanol can avoid the 60 cent tariff (contained in Item 901.50 TSUS) is by entering the U.S. as gasohol--a blend of gasoline and ethanol -- which is then dutied at the 1.25 cents per gallon motor fuel rate. Both H.R. 1566 and H.R. 1720 attempt to eliminate this by amending Item 901.50 of the TSUS to include "any mixture containing such ethyl alcohol if such ethyl alcohol or mixture is suitable for use as fuel or for use in producing a mixture of gasoline and alcohol or a mixture of a special fuel and alcohol for use as a fuel." While this language would ensure that ethanol in gasohol does not circumvent the 60 cent tariff, it appears to apply the 60 cent tariff to the whole mixture rather than prorating it on the ethanol portion. Thus, these bills could also require that gasoline containing a small amount of ethanol (e.g., for use as an octane enhancer in unleaded gasoline) be assessed a 60 cents per gallon tariff, not the 1.25 cent motor fuel tariff it should receive.

API believes that any tariff legislation pertaining to gasoline/ethanol blends should be structured and clearly worded to: (1) separately tax the components of the product, i.e. the motor fuel component at the existing duty for motor fuel and the ethanol component at the ethanol duty, and (2) ensure that the appropriate enforcement mechanisms are developed. This same approach should also prevent circumvention of the 60 cent tariff for imports through Foreign Trade Zones, whereby ethanol is blended with gasoline in a Foreign Trade Zone and then enters the U.S. as gasohol receiving the 1.25 cent rate.

Based on current Customs administrative rulings, ethanol imports can also avoid the 60 cent duty by entering the U.S. through Caribbean Basin countries and possibly through insular possessions of the U.S. Of the three above-cited ethanol bills, only H.R. 1720 addresses both of these concerns.

The U.S. Customs Service recently determined that hydrous alcohol imported to a Caribbean Basin (CB) country and dehydrated through azeotropic distillation to anhydrous alcohol undergoes a substantial transformation and can therefore enter the U.S. duty-free because it qualifies as a new and different article of commerce under the Caribbean Basin Economic Recovery Act (CBERA). Although Customs has solicited comments on its determination (50 FR 14250: April 11, 1985), it is unclear whether Customs will change this practice. Therefore, legislation may well be necessary to prevent this ethanol from receiving duty-free status.

While H.R. 1567 does provide that ethanol or gasoline/ethanol mixtures are not eligible for duty-free treatment merely by virtue of being distilled or denatured in a CB country, the language amending the CBERA in H.R. 1720 is more precise. Also, H.R. 1720 , unlike H.R. 1567, would prevent ethanol from circumventing the 60 cent duty by entering the U.S. through an insular possession in a manner similar to that under the CBERA.

In summary, API believes H.R. 1720 addresses the major concerns regarding the means by which ethanol and gasoline/ethanol blends circumvent the 60 cents per gallon duty on fuel ethanol which were outlined in the ITC report. This bill would clarify that Congress intended to encourage the development of alternative domestic energy sources by subjecting all fuel ethanol imports to the duty in Item 901.50 TSUS. However, API believes that the language in both H.R. 1566 and H.R. 1720 is too broad because, as written, "any mixture containing ethyl alcohol" would receive the 60 cents per gallon duty, thus, imposing the ethanol tariff on the entire mixture rather than only on the ethanol component. Finally, API supports creating a separate tariff category for motor fuel blendstocks with a tariff rate no lower than that of motor fuel. Both H.R. 2354 and H.R. 2396 address the blendstock issue and set duties equal to or higher than the motor fuel rate, however, they do not explicitly exclude ethanol as a blendstock and thus may inadvertently create an additional means for ethanol to circumvent the 60 cent tariff.

We thank you for the opportunity to comment on this legislation. If you have any questions or need additional information, please contact Ed Beck in API's Federal Relations Department at 682-8418.

Sincerely,

Charles J. DiBona

Attachment

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8440

Arnold Moore
Federal Agencies Director

June 13, 1985

Commissioner of Customs
Regulations Control Branch
1301 Constitution Avenue, N.W.
Room 2426
Washington, D.C. 20229

Dear Sir:

The American Petroleum Institute appreciates the opportunity to comment on Customs' determination that "beverage grade" ethanol that is transformed into "fuel grade" ethanol in Caribbean Basin countries may qualify for duty-free entry into the United States under the Caribbean Basin Economic Recovery Act (hereafter, CBERA or the Act) 50 Fed. Reg. 14250, April 11, 1985. API is a trade association of 230 companies and 6000 individual members who are engaged in all aspects of the petroleum industry including exploration, production, transportation, refining and marketing. Since API's members produce and market not only gasoline, but also, in some cases gasohol, API and its members have a direct and substantial interest in the apparent duty-free classification of fuel ethanol under the CBERA.

The petroleum industry is concerned that the existing tariff structure, as currently applied, presents unwarranted opportunities to frustrate Congressional intent through the avoidance of the present 60 cents per gallon duty on fuel ethanol. The duty on imported fuel ethanol is a balancing component of a multifaceted Congressional effort to encourage the development of the domestic ethanol industry. An important element of that effort was the federal excise tax exemption for gasohol containing at least 10 percent alcohol, which was created by the Energy Tax Act of 1978 (Pub.L. 95-618). Because it was impossible to limit that tax exemption to domestically produced ethanol under applicable trade agreements, Congress imposed an additional tariff on imported ethanol equal to the value of the excise tax exemption. The Crude Oil Windfall Profit Tax Act of 1980 (Pub.L. 96-223). See, S. REP. No. 394, 96th Cong., 2nd Sess. 91, reported in [1980] 3 U.S. CODE CONG. & AD. NEWS 410, 500. Regardless of the form used, Congress clearly and unequivocally expressed its intent to encourage the development of the domestic ethanol industry, an industry which has the potential to help reduce the nation's dependence on imported oil through the development of an alternate source of domestic energy.

Although the policy goals of the CBERA are laudable (i.e., to promote economic revitalization and facilitate expansion of

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economic opportunities in the Caribbean Basin), its reach should be interpreted narrowly when the possible result would be to frustrate such a clear expression of Congressional intent. *Cf. Heaven Hill Distilleries, Inc.* v. *United States*, 476 F. 2d. 1327, 1331 (Ct. Cl. 1973). API believes that the Customs' determinations of January 3 and September 12, 1984, fundamentally miscontrue and misapply the CBERA and its implementing regulations.

Under the CBERA, an article of commerce imported into the U.S. from a beneficiary country is eligible for duty-free entry if: (1) the article is a new or different article of commerce which has been produced in a beneficiary country; *and* (2) 35% of the cost or value of the materials and related processing of the article was accrued in the beneficiary country. Anhydrous ethanol is not a new or different article of commerce vis-a-vis hydrous ethanol (usually 150-190 proof), and does not meet the eligibility criteria set out under the CBERA.[1] Therefore, it should not be allowed to enter the United States duty-free. Also, since neither anhydrous nor hydrous ethanol undergoes substantial transformation in a beneficiary country, neither their cost nor value can be included in the 35% added value-content requirement of Sec. 2703 (a)(1)(B). Thus, neither of the criteria for duty-free entry is fulfilled.

In its January 3, 1984 letter, the Customs Service ruled that anhydrous ethanol produced from hydrous ethanol was a new or different article of commerce. Customs' decision relied on the petitioner's statement of "fact" that hydrous ethanol could not be used as a motor fuel, while anhydrous ethanol could.

In order to be a "new or different article of commerce" the new article must have a distinctive name, character or use. *See generally*, *Anheuser Busch Brew. Asso.* v. *United States*, 207 U.S. 556, 562 (1908). Since modifying the word ethanol with the adjective 'beverage' or 'fuel' does not change the fact that the article of commerce under discussion is still ethanol, the new or distinctive "name" criterion is not met. Moreover, since the molecular composition of anhydrous ethanol is the same as hydrous ethanol, C_2H_5OH, it should be equally clear that the new and different "character" criterion is also unmet. Finally, no new or different use determination is proper, since both anhydrous and hydrous ethanol are potable and can be used as motor fuel.[2] In short, under generally accepted legal principles, anhydrous ethanol is not a "new or different article of commerce" vis-a-vis hydrous ethanol.

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[1] 19 U.S.C. §2703 (a)(1) and (a)(2).

[2] For a more detailed discussion of the use of hydrous versus anhydrous ethanol see the comments submitted by the Kentucky Agricultural Energy Corporation, May 24, 1985, and the petition submitted by William and Connolly.

Even if these general legal requirements were somehow met, anhydrous ethanol still would not be a "new or different article of commerce" for purposes of the CBERA. The Act expressly excludes an article from duty-free treatment by virtue of its merely having undergone "dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article." Section 2703 (a)(2)(B). This exclusionary language was added to ensure that the intent behind duty-free treatment under the CBERA (i.e., encouraging economic development and employment opportunities within the Caribbean) would not be frustrated by simple processing which did not contribute to these goals. Here, just the opposite of dilution (i.e., dehydration) is occurring, but the result as far as the CBERA's goals are concerned is the same. Since diluting anhydrous ethanol with water in order to produce hydrous ethanol would clearly not result in a "new or different article of commerce" under Sec. 2703(a)(2)(B), so, too, merely dehydrating hydrous ethanol to produce anhydrous ethanol should not result in a new article of commerce entitled to duty-free treatment under CBERA. Accordingly, we believe the Customs Service's January 3 determination is in error.[3]

The September 12, 1984 determination which raises related issues is in error for the same reasons discussed above. At issue in the September determination was whether anhydrous ethanol produced from non-Caribbean hydrous ethanol constituted a "material produced in a beneficiary country" such that the cost or value thereof could be used in meeting the 35% value-content requirement of Sec. 2703(a)(1)(B)(i).

Applicable Customs Service regulations implementing the CBERA define "materials produced in a beneficiary country" as referring "to those materials incorporated in an article which are substantially transformed in any beneficiary country into a new or different article of commerce which is then used in any beneficiary country in the production of a new or different article that is imported directly into the United States" (emphasis added) 19 C.F.R. §10.196 (a)(2). As discussed earlier, anhydrous ethanolis not a new or different article of commerce vis-a-vis hydrous ethanol and, therefore, cannot be deemed a "material produced in a beneficiary country."

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[3] Even if anhydrous ethano lwas a "new or different article of commerce", it is clear that neither its cost nor value could be used to satisfy the 35% added value-content requirement. 19 C.F.R. §10.196 (a)(Example 2).

As correctly observed by the Customs Service, "substantial transformation" requires that the product be the result of a "substantial manufacturing or processing operation." The Customs' determination that the first stage of distillation (i.e., increasing the proof from 150-190 to 190+) is not a substantial manufacturing process is clearly correct. Similarly, the second stage (i.e., the transformation into anhydrous ethanol) should also fail this test because it is also simple and not substantially different in kind from the first stage of distillation. Thus, anhydrous ethanol produced in the Caribbean does not qualify as a "material produced in a beneficiary country," as defined by Section 2703(a)(1)(B)(i).

As a final basis, a "material produced in a beneficiary country' must also be used in the production of a "new or different article". See generallly, Torrington v. United States, 596 F. Supp. 1083 (Ct. Int. Tr. 1984). Even if the ethanol being imported directly to the U.S. is denatured (i.e., combined with a substance such as gasoline to render it not potable), it should not receive duty-free status.

The Act precludes duty-free treatment for an article that becomes a new or different article of commerce "by virtue of having merely undergone simple combining or packaging operations.' Sec. 2703(a)(2)(A). Denatured ethanol is clearly the result of a simple combining operation (i.e., denaturing) in a beneficiary country. For this added reason, we believe the Customs' determination is in error.

In conclusion, API believes that Customs' the above-cited determinations are in error and should be changed because dehydration of hydrous ethanol is not a substantial manufacturing process and therefore anhydrous ethanol is not a new or different article of commerce under the CBERA. In addition, the Act's 35% added value-content eligibility criteria for duty-free entry is not met. Therefore, imports of anhydrous ethanol and denatured ethanol should not be allowed to enter the U.S. duty-free under the CBERA and the 60 cents per gallon tariff should apply as Congress intended.

We thank you for the opportunity to comment on this issue. If you have any questions or need additional information, please contact Judy Tillman in API's Federal Agencies Department at 682-8452.

Sincerely,

Art Moore

BEST COPY AVAILABLE

STATEMENT OF HON. BEN BLAZ, A DELEGATE TO CONGRESS FROM GUAM

I oppose H.R. 1567 and H.R. 1720 as yet more attempts to stifle private enterprise in the U.S. insular territories and to terminate the benefits of headnote 3(a). This Congress enacted headnote 3(a) to encourage the territories to pay their own way through private investment and enterprise. Our island possessions, bereft of natural resources and burdened by Federal regulations, cannot compete with their low-wage, island neighbors without some form of investment incentive. The elements of headnote 3(a)—duty and quota-free treatment and the processing of foreign materials—were chosen expressly by Congress as the appropriate incentives. The alternative was and continues to be utter dependence on direct Federal subsidies. This strategy has worked in some measure. Light industries have arisen and prospered, employing U.S. citizens and providing local tax revenues. The ethanol industry promises to follow this pattern. The plants are well-suited to the islands' needs. The plants will ultimately use local materials to produce ethanol which is required by the domestic market. the Customs Service has already determined that all of the conditions of headnote 3(a) have been met. H.R. 1567 and 1720 are intended to remove the benefits of the headnote from this infant territorial industry.

Petrocarbon Associates, Inc., an American Company in Arizona, has indicated that it will begin the operation of an ethanol plant in Guam in May of this year. The company intends to use both the azeotropic and molecular distillation processes. The wages and revenues generated by this plant will enable Guam to reduce its dependence on Federal funds. In this era of Federal belt-tightening private employment and tax revenues are not luxuries. They are necessities.

The headnote 3(a) policy of encouraging private investment in the insular possessions was first enacted in 1907 with regard to the Phillipines—then a U.S. possession. During the intervening decades Congress has consistently strengthened and expanded this needful policy. Congress also created the Customs Service to enforce the customs laws of this country, including headnote 3(a). H.R. 1567 and H.R. 1720 will undermine not only the foundations of headnote 3(a), but also the integrity of the Customs Service. If these bills pass no one will be able to place any faith in the rulings of the Customs Service. Customs has already determined that even under the newly revised and tightened origin rules ethanol production qualifies as a territorial product, and is, thus, eligible for headnote 3(a) treatment. These bills will reverse the impact of the ruling and inject an element of uncertainty into all Customs decisions. No business will invest in such an atmosphere. I, therefore, respectfully oppose the bills.

STATEMENT OF HON. RON DE LUGO, A DELEGATE TO CONGRESS FROM THE VIRGIN ISLANDS

In its report on the Tax Reform Act of 1985, the committee agreed on the need to establish a rule with respect to imports of alcohol under the Caribbean Basin initiative and T.S.U.S headnote 3(a) which would, quote, permit orderly growth in such imports while at the same time phasing out use of the program of merely removing water from alcohol transferred from other countries, end quote. I would like to propose such a rule.

Limit the period during which azeotropic distillation, the process of removing water from alcohol, would be acceptable transformation for purposes of duty-free entry under the CBI or headnote 3(a) to a period of no more than one year. This would allow each investor a reasonable start-up, or transition, period, while assuring that ethanol plants would be committed to full scale production from raw agricultural product into fuel grade alcohol within a very short period of time.

As the committee report points out, azeotropic distillation requires considerably less capital investment and fewer employees than are needed for full production of ethanol. I believe the other beneficiaries of headnote 3(a) and the CBI countries share the view held by the Virgin Islands that it is far more attractive to host the complete ethanol plant. It is also clear that the start-up costs are high. By allowing a reasonable phase in, the incentive to locate in these beneficiary areas will be more meaningful.

It has been difficult to attract industry to the Caribbean countries, despite trade benefits and concerted promotional efforts. The situation is similar in the U.S. insular areas. The ethanol plant in Jamaica is one of the few CBI success stories. What bills like H.R. 1720 and H.R. 1567 suggest is an intention to withdraw the trade benefits as soon as there is serious interest in taking advantage of them. The committee report, however, suggests real interest in assuring meaningful investment in these struggling economies.

The second largest plant in the Virgin Islands and a major employer on the island of St. Croix, closed its doors this year. The largest plant laid off 300 employees. The direct loss in jobs was approximately 800 persons, but the impact on supporting industry has brought the number to over one thousand. Such a loss is impossible for the Virgin Islands to absorb without attracting new business, and quickly. The Virgin Islands is counting on a current proposal to produce ethanol involving at least 50 new jobs and over $20 million in capital investment within the year. The prospective investors have made it clear that they need phase-in production, and that dutyfree access during this period for the distilled alcohol is crucial. There are few products, not already effectively exempt from the duty-free benefits, which could illicit such interest in the territory.

Statement of Congressman Byron L. Dorgan of North Dakota

Mr. Chairman: I appreciate the opportunity to testify in support of my Colleague's bills, H.R. 1720, H.R. 1566 and H.R. 1567, to close the glaring loopholes that exist in the regulations governing the importation of ethanol. This legislation will offer Congress the unique opportunity to address three very crucial issues: the farm crisis, the trade deficit and the need for energy independence.

The Durbin-Leach bills will firmly establish Congressional support for the domestic ethanol industry and clarify the intent of the Caribbean Basin Economic Recovery Act, designed to support the grass-roots development of a sugar based ethanol industry.

The domestic ethanol industry deserves our attention and cooperation. Ethanol is not only an asset to the nation as we begin to phase out leaded gasoline, but it provides a much needed additional market for America's corn and barley farmers. It is vital that we continue to support our ethanol industry—a significant contributor to our overall economy by decreasing the farmers reliance on federal price supports and increasing the job opportunities for depressed labor forces such as construction, railroad, trucking and agriculture.

While our domestic industry is certainly our first priority, in 1983 Congress agreed to a Reagan Administration initiative to stimulate investment in the Caribbean Basin by allowing the duty-free importation of grass-roots produced ethanol. The Durbin-Leach bills do not intend to circumvent the legal development and production of ethanol by Caribbean nations, they set out to close the loopholes which are so devastating to both the American and Caribbean ethanol industries.

Through a more concise definition of CBI qualified ethanol products, other nations will not be able to simply pass their ethanol through Caribbean nations and avoid the 60 cent duty. In order to qualify for duty-free importation, the product would have to undergo substantial transformation, not simply a denaturing or distillation process while it is in a Caribbean country. Unfortunately for the American farmer and for the U.S. Treasury, which has lost significant revenues, ethanol is currently being imported without duty by virtue of its simple "passing through" a Caribbean nation.

During the past few months I have worked with Congressman Durbin, Congressman Daschle, Congressman Leach and others to remedy the growing problem of duty-free ethanol imports. After learning that due to a private letter ruling issued by the U.S. Customs Service ethanol-toluene blend was being imported from Brazil duty free, we wrote to and spoke with Secretary James Baker and later met with the Brazilian Ambassador in hopes of putting a halt to the damage being done to the domestic ethanol industry. At long last we were successful, but it was not long before ethanol was being blended with benzene in order to avoid the .60 cent duty. Clearly this recurring problem is not adequately being addressed through the Customs service; Congress needs to take constructive action.

By closing these glaring loopholes, the Durbin-Leach bills will not only prevent the recurring problems of duty-free Brazilian ethanol but they will reaffirm our commitment to America's ethanol industry and ensure a market for our farmers.

[The following statements of the Governments of El Salvador and Panama were submitted by Congressman Durbin with the permission of Chairman Gibbons.]

Statement of the Government of El Salvador, Presented by Carlos Escamilla, Special Advisor to Instituto Nacional Del Azucar

Mr. Chairman: It is indeed an honor to be given the opportunity to appear at this Trade Subcommittee of the House Ways and Means Committee on this occasion.

My name is Carlos Escamilla and I am Special Advisor to the Instituto Nacional del Azucar, which is the sugar agency of the Government of El Salvador. INAZUCAR is the sole producer and exporter of "grass roots" ethanol from El Salvador and one the few countries within the Caribbean Basin Economic Recovery Act to be actively engaged in the diversification of sugar cane production for economic development purposes.

It is important to mention that El Salvador started its alcohol program with the construction of its first plant at the El Carmen sugar mill for production in the middle of 1980, and it was exporting ethanol to the United States by 1984. I think it is also important to keep in mind this fact, in order to appreciate that El Salvador, prior to the enactment of the CBI Legislation in the United States had already entered into a diversification program for purely economic reasons. Most certainly the enactment of the CBI Legislation has further encouraged El Salvador to take full advantage of the benefits that are inherent in that Legislation.

With regard to H.R. 1567 and H.R. 1720, the Government of El Salvador would like to be put on the record that it fully supports the exclusion of ethyl alcohol used for fuel to be imported into the United States, which is merely distilled or denatured in a beneficiary country, when such raw material is originated in other areas outside of the CBI region.

The reason for our support of H.R. 1567 and H.R. 1720 is that El Salvador considers that sugar cane as well as other agricultural products and raw materials for the production of ethanol exist in sufficient amounts in the countries of the CBI region as feedstock for alcohol production. To import such a raw material in whatever form for simple distillation or denaturalization to be processed for re-export to the U.S. should be viewed in its long-term effect. This detracts from the economic incentives of the CBI Legislation which El Salvador considers to be an important facility in helping to spark economic recovery of the Caribbean and Central American countries. This economic recovery helps to preserve jobs and political stability in the region and guarantee an important flow of foreign exchange to my country.

We fear that an uncontrolled proliferation of dehydration-only alcohol plants in the region with little or no utilization of raw materials produced in the CBI countries represents a serious threat that could defeat the very purpose of the benefits contained in the CBI Legislation. Furthermore, export opportunities for sugar cane by-products such as alcohol represent a real and long-term solution to raw sugar production that is having an increasingly reduced access to the U.S. sugar market.

Mr. Chairman: We are very seriously concerned by the adverse effects that my country could suffer with the loss of an already large investment undertaken in the construction of full-scale fermentation and distillation ethanol plants for export. Already twenty million dollars (US$ 20,000,000) have been invested, and an additional twenty million dollars have been committed to this new industry. You can appreciate that a forty million dollar (US$ 40,000,000) investment in developing this new area of our national economy to reduce our dependency on sugar exports to the U.S. and other World markets in the troubled circumstances that our democracy is undergoing is a concrete act of faith and confidence in ourselves and in this industry. The CBI Legislation encourages us to do this, and that is why we encourage you to not allow a loophole to threaten this effort.

Mr. Chairman: I want to thank you and this distinguished Subcommittee on behalf of the Government of El Salvador for the opportunity allowed to me to express our views in support of H.R. 1567 and H.R. 1720.

STATEMENT OF THE GOVERNMENT OF PANAMA, PRESENTED BY MANUEL D. CABARCOS

Mr. Chairman, my name is Manuel D. Cabarcos. I am currently serving as President of Cia. Azucarera La Estrella S.A., one of the two private sugar mills in the Republic of Panama. I am presenting this testimony today on behalf of the Government of Panama. We very much appreciate the opportunity to address the issues involved here and I am testifying today because our Government supports the legislation introduced by the sponsors of H.R. 1567 and 1720.

The sugar industry is of substantial importance to a considerable number of countries in the Caribbean region, including Panama. The sugar industry in Panama is both a source of employment and foreign income and is of critical importance to our balance of payments. The sugar industry's economic welfare is also of significant political and social importance to the Government of Panama.

Panama is very concerned about the long-term prospects for the sustained demand of imported sugar by the industrialized countries. Furthermore, the possibilities of expanding shipments of sugar to new markets are not promising. For these and other reasons, all of the Caribbean Basin countries, including Panama, will have to make decisions and adopt policies searching for solutions to these long-term problems. If we do not find solutions, we will face large reductions of employment in the sugar industry and eventual closing of sugar mills with the consequent impact on labor and social unrest coupled with big losses of foreign income.

The Government of Panama believes that partial conversion of Panama's sugar industry into an agro-industrial energy industry provides one of the possible answers to our sugar problem. Because Panama has the potential for producing ethanol from our domestic sugar industry, we consider this a viable alternative. It would add some stability to our domestic sugar industry, maintain Panamanian employment, and strengthen our balance of payments situation; it could also reduce our dependence on fossil fuel, if gasohol is found to be economically and otherwise feasible for use in Panama.

Panama is very much aware of the success of the ethanol programs of some of our neighboring countries. Costa Rica, for instance, has the Central Azucarera Tempisque SA (CATSA), a sugar-alcohol complex which has two distillation units with a combined capacity of 63,400 gallons per day. Under the Caribbean Basin Initiative program, the ethanol produced from this facility enters the United States duty-free.

El Salvador also has a distillery complex which is manufacturing ethanol. The distillery is called Planta Gasohol and is attached to the El Carmen Sugar Mill in San Salvador. The plant was designed to process sugar cane molasses and/or sugar cane juice, and has an installed capacity of 16,000 gallons a day. El Salvador has already begun exporting duty-free ethanol to the United States under the Caribbean Basin Initiative program, and it is our understanding that they are actually considering doubling their present alcohol producing capacity.

The Panamanian sugar industry increased sugar production over the last 20 years to a maximum of 225,000 metric tons in 1979. Since then, sugar production has decreased to levels lower than 1979 because of low sugar prices in the international market. Sugar is in second place in the balance of payments for farm products exported by Panama. The domestic sugar industry currently employs a significant percentage of the country's agricultural labor force.

In view of the likely future limitations on increasing sugar exports and the fact that existing Panamanian sugar facilities are not being fully utilized at present, the feasibility of making fuel alcohol for both the domestic and export markets is being considered by our Government.

However, Panama is concerned about the current situation whereby a loophole in the Caribbean Basin Initiative program will make the development of this new industry very difficult. If this situation is allowed to persist, most of the ethanol which will enter the United States from the Caribbean region might be dehydrated ethanol from the type of facilities which have promoted the introduction of the legislation you are considering at this hearing. If the current loophole remains open, it would make it very difficult for us to obtain the investment necessary to utilize our sugar cane in the production of ethanol.

The Government of Panama believes that when the United States Congress created the Caribbean Basin Initiative program its intent was to stimulate capital investment in this region so as to utilize Caribbean labor and raw materials as much as possible. We fully support this policy. Certainly the construction of complete ethanol facilities capable of transforming our country's raw materials into ethanol is a worthy policy goal and wholly in keeping with the spirit and letter of the Caribbean Basin Initiative program's concept. However, the circumstance whereby a non-Caribbean country is allowed to funnel its ethanol through the Caribbean is not only a clever use of a loophole to avoid paying the U.S. duties, but a serious distortion of the program that will inhibit and perhaps even prevent the very goals it was intended to bring about.

The Government of Panama, as well as private investors, are, therefore, very hesitant to pledge the necessary financial resources to construct ethanol manufacturing facilities as long as the current situation exists.

Panama is very supportive of the Caribbean Basin Initiative. It is a bold and imaginative concept that can strengthen the economy of our region. We believe, however, that allowing this concept to be disrupted, as is happening in this case, is not in the interest of your country nor in the interest of most of the countries of the Caribbean region. We respectfully recommend to this subcommittee to give favorable consideration to the legislation embodied in H.R. 1567 and 1720.

Greater Rockford Energy and Technology Corporation

8399 Lindenwood Road
Rockford, IL 61109-5237
(815) 874-2387

FEB 13 1986
WAYS AND MEANS

Mr. Joseph Dowley
Chief Counsel
Committee on Ways & Means
1102 Longworth Bldg.
Washington, D.C. 20515

Re: Subcommittee
on Trade Committee
on Ways & Means
Feb. 7, 1986 hearing

Dear Mr. Dowley:

My name is Trahern P. Ogilby Chariman of the Board of Greater Rockford Energy & Technology Corporation, 8399 Lindenwood Rd., Rockford, Ill., 61109-5237 - Tel. #815-874-2387, a 3 1/2 million gal. pr. yr. Ethanol producer in Rockford, Ill.

Inasmuch as the hearing dealt exclusively with the import tax on Ethanol imported from Jamaica under the Caribbean Basin Initiative, I wish to direct my comments on the two principals involved; namely, testimony given by Richard V. Vind, President and Chief Executive officer of Tropicana Petroleum LTD. and its affiliate Tropicana International Jamaica LTD. and the U.S. Customs Dept.

Tropicana markets their Ethanol product in the Chicago and Rockford, Ill. area. They are currently contemplating a blending operation in Rockford. Their Ethanol product is allowed to be brought in from Jamaica tax-free - our very survival is at stake.

Our Ethanol plant purchases 1,250,000 bushels of local corn. Ferments, distills, and refines Ethanol to a pure 200 proof state.

Tropicana is a middle man. They take other peoples' product, refine 5% water out of the Ethanol in Kingston, Jamaica and claim a 35% value added requirement has been met and ship into the USA tax-free. Testimony by the Customs Dept. stated this process costs 12 cents to 15 cents - on an average price of $1.00 per gallon - Value added would be 12% - 15% falling far short of the required 35% value added requirement of the CBI law. Out capital cost for similar equipment to perform this drying operation cost 7 1/2% of total equipment const.

Producers of
Supral
Pure ethanol used as an octane enhancer in unleaded gasoline
SupraNutra
High nutrient feed stock

-2-

On Oct. 27, 1985, I visited the Tropicana installation in Kingston, Jamaica. They invited me in and showed me the entire process. The employment of 76 people and 23 security guards is vastly exaggerated over figures I was given when I was there.

After visiting the plant, I have strong feelings that what I saw was the "tip of the iceberg". Although I have not received hard answers to my question, I have strong suspicions from information gathered elsewhere that they are currently in phase one of a three-phase projected plan. There is other evidence that they are looking on continued expansion. I saw a new boiler being put into place to duplicate their boiler capacity and that one of the consulting engineers is moving his family to Jamaica.

Tropicana is our primary competitor here in the Rockford area. They are shipping some product into this area from Jamaica and buying the balance, primarily from ADM. They have announced that they have bought facilities to blend product here in Rockford.

Even in the face of this competition, I feel that in all fairness they are entitled for a reasonable time to ship in under this CBI regulation 20 million annual production. They acted in good faith, and after receiving the letter from the customs department went ahead and spent considerable money to establish a free trade zone area in Kingston. I do not agree with the customs ruling, and I feel very strongly that Azetropic Distillation does not qualify for the 35 percent value added requirement. I also feel that further distilled product should not be admitted into the USA as a result of further expansion. This opinion would be modified if they somehow started to ferment and distill in the CBI area and then I would feel that a final product from this entire process of ethanol production should be admitted into the USA under CBI tax-free provision.

The USA is currently losing $12 million (60 cents x 20 million gallons). The only benefit that I can see currently is that they are hiring approximately 25 to 30 Jamaicans. They pay no taxes to Jamaica for products received, nor on products going out and no taxes on capital equipment erected there. I feel we both agree that that is a pretty high price to pay for 25 jobs.

Sincerely,

Trahern P. Ogilby

Producers of
Supral
Pure ethanol used as an octane enhancer in unleaded gasoline
SupraNutra
High nutrient feed stock

EMBASSY OF JAMAICA
1850 K STREET, N.W.
SUITE 355
WASHINGTON, D.C. 20006

TELEPHONE (202) 452-0660

REF. NO.

February 13, 1986

Dear Congressman Gibbons:

Re: Ethanol Legislation H.R. 1566,
H.R. 1567, H.R. 1720 and H.R. 4094

I have the honour to submit hereunder for the kind consideration of your Committee, the position of the Government of Jamaica on the abovementioned bills:

> "The Government of Jamaica is not in support of the legislation under consideration (HR1566, HR1567, HR1720 and HR4094) and requests the Committee to consider the following:
>
> 1. Prior to the introduction of the CBERA and its potential for duty-free alcohol supplies to the U.S.A., the sugar industry in Jamaica declined substantially due to the falling sugar prices in the international market.
>
> 2. Recognizing the opportunities offered in the supply of alcohol to the U.S.A. under the CBERA, Jamaica has embarked upon an extensive rehabilitation programme of factories and plantations, starting with one of the largest mills in Jamaica -- the Bernard Lodge Estate, converting the mill to alcohol production.
>
> 3. The alternative to such a conversion would be the closure of the abovementioned sugar factory which had deteriorated as a result of low international sugar prices and the consequent lack of investments. The closure of this factory would result in the direct loss of some 981 jobs for both skilled, semi-skilled and unskilled labour

/2...

The Honourable Sam Gibbons
Chairman, Trade Sub-committee
House, Ways and Means Committee
Longworth House Office Building
Washington, D.C. 20515

(excluding loss of secondary employment in other industries dependent on the sugar industry).

4. Fundamental to this rehabilitation programme is a 40-million gallon per year dehydration facility at the Petrojam refinery. In this connection, a substantial investment has already been committed. However, as the rehabilitation programme will entail both time and capital, initial operations of this dehydration facility, which are scheduled to commence in July 1986, must be based on a mixture of imported and domestic alcohol.

5. It is anticipated that the Bernard Lodge Estate will produce 20 million gallons of domestic alcohol by 1987, providing more than 3,200 jobs.

6. It is also important to recognize that this programme also envisages the production of energy cane, i.e, cane with a high fibre content which will allow the co-generation of electricity for supply to Jamaica's national grid. Additional spin-offs include biogas recovery and cattle feed production from the fermentation process.

7. The Committee should further be aware that 97 percent of Jamaica's commercial energy which consumed 40 percent of our export earnings in 1985, is supplied from imported petroleum. Energy cane offers the first positive opportunity for the generation of electricity utilizing an indigenous and renewable fuel.

8. Such an ambitious programme, which eventually will phase out and replace imported alcohol with domestic production cannot be realized overnight, nor can it be successful in the absence of the profits to be derived from the dehydration operation. The Jamaican farmer needs to be assured of a steady outlet for his cane and the entire project will not only avoid the loss of jobs and provide additional employment but will go a long way to reduce Jamaica's dependence on imported oil through co-generation using energy cane.

/3...

9. The fuel ethanol market in the U.S. seems quite substantial and promises to be even greater with the lead phase out programme in place. Under these circumstances it is apparent that the U.S. market could accommodate the CBERA type operations described herein without any dislocation to existing U.S. producers."

Sincerely,

Keith Johnson

Keith Johnson
Ambassador

KENTUCKY AGRICULTURAL ENERGY CORPORATION
Power Alcohol · DDGS · Grain

June 26, 1985

FEDERAL EXPRESS

Mr. James Dowley,
Chief Counsel
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Dowley:

This letter is in response to the solicitation of comments by the House Ways and Means Committee in regard to proposed legislation to prevent the current abuse of non-qualifying ethanol alcohol entering the United States without paying the tariff duty. (H.R. 1720, H.R. 1566 and H.R. 1567).

The following comments are submitted on behalf of a domestic ethanol alcohol manufacturing plant that contends that the ethanol alcohol imported from several Caribbean Basin countries are currently incorrectly classified under the Caribbean Basin Economic Recovery Act (CBERA) as being eligible for duty-free entry into the United States.

The facts will prove that the removal of water from 150 or 190 proof alcohol to produce 200 proof alcohol is not a substantial manufacturing process and does not produce a new or different article of commerce. Therefore, the duty prescribed for fuel-grade ethanol alcohol in the tariff schedule should be enforced.

Comments will be made in reference to Department of Treasury, Customs Service (Customs) letters dated January 3, 1984, CLA-2, CO:R:CV:DS, 071693TL and September 12, 1984, CLA-2, CO:R:CV:V, 553209HS.

Post Office Box 657, Franklin, Kentucky 42134 502-586-9586

The first statement by the Customs letter to be addressed is the misconception that beverage (150-190 proof) ethanol is not usable as motor fuel. The principals involved in requesting the referenced letter rulings should be well aware of the fact that numerous countries, and specifically Brazil, fuel millions of vehicles on "beverage grade (hydrous) ethanol".

According to a report[1] by the Brazilian Institute of Alcohol and Sugar (IAA) or Instituto Do Acuczr e Do Alcool which conducted a study projecting the demand for anhydrous (200 proof) ethanol for motor fuel to be 1,670,000,000 liters for 1985 and 1986 and the demand for hydrous alcohol motor fuel (beverage grade) to be 6,900,000,000 liters for 1985/1986.

Another report[2] by Dr. David Drake, a Brazilian auto expert, says that Ford do Brasil released production numbers showing that in 1984, 568,214 hydrous and anhydrous alcohol-burning vehicles were manufactured, which represents 83.9% of the total new vehicles produced in Brazil.

A government report [3] entitled "Fuel Alcohol, An Energy Alternative for the 1980's" states, "When used as a pure fuel rather than in a blend, alcohol can be less than anhydrous - from 175-190 proof - and thus can be produced using less energy and at lower cost than can anhydrous alcohol."

1. Alcohol Update Newsletter, April 1, 1985, published by Information Resources, Inc. of Washington, D.C.
2. Alcohol Update Newsletter, March 18, 1985, published by Information Resources, Inc. of Washington, D.C.
3. Final Report, U.S. National Alcohol Fuels Commission (created by U.S. Congress) Washington, 1981 Library of Congress, Number: 81-65219 ISBN 0-9605762-0-7

In addition to the three reports quoted, there are hundreds of articles and reports published from the late 1970's through 1985 that document that vehicles have been running domestically and abroad on beverage-grade alcohol for years. Most of the pioneer work done in the use of alcohol as a fuel in the United States was done by Henry Ford in the early 1900's. General Motors, Ford, Volkswagen and many other companies currently produce vehicles that run solely on hydrous ethanol alcohol.

Therefore, transforming 150-190 proof ethanol to 200 proof ethanol does not involve a substantial transformation and does not change the product's identity because either grade of alcohol can be used as fuel.

Addressing the statement that processing 150-190 proof ethanol to 200 proof ethanol is a substantial processing operation and a substantial transformation into a distinct new product, goes beyond the bounds of the (CBERA). This transformation is nothing more than a simple process to remove water from a liquid. In this process, the chemical formula of 150-190 proof ethanol ($2C_2H_5OH$) is the same as the chemical formula of 200 proof ethanol) ($2C_2H_5OH$). This information can be found in any high school or college chemistry textbook.[4]

Customs has embarked on an extremely sensitive area by implying that it possesses the technical expertise and knowledge of the alcohol industry to be able to express an opinion on the economic feasibility of different types, (i.e., beverage vs. fuel), of alcohol production. In

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4. Example: Chemistry of Organic Compounds, by Noller, Library of Congress, Catalog #57-7045.

particular, it has stated that "within the trade, motor fuel ethanol is considered to be a different article of commerce which is significantly more valuable than beverage ethanol". If an economic feasibility study is to be undertaken to prove or disprove these statements, it should also include the economic impact to the U.S. domestic alcohol production facilities that will be threatened by the flood of duty-free ethanol that could enter the U.S. because of the letter rulings that Customs has issued.

The negative economic impact of these rulings could close plants nation-wide with the loss of millions of dollars of revenue and thousands of jobs. An economic feasibility of a "stand-alone" hydrous alcohol to an anhydrous alcohol distillation facility would be extremely hard to compare because there are no known facilities of this type operating today in the United States. However, several domestic alcohol plants produce both beverage and fuel-grade alcohol from the same equipment. This fact alone should weigh heavily in the determination that removing water from alcohol on a "stand-alone" basis is not a processing operation that transforms or produces a new or different article of commerce.

It would be quite appropriate for Customs to inquire of its two sister organizations in the Department of Treasury, i.e., the Alcohol, Tobacco and Firearms Division and the Internal Revenue Service, for their expertise in alcohols.

Specifically, the following is an excerpt from the Department of Treasury, Bureau of Alcohol, Tobacco and Firearms publication, Alcohol Fuel and ATF, Publication #ATFP 5000.2 (8/79):

> "The Bureau of Alcohol, Tobacco and Firearms is responsible for administering the laws of the Internal Revenue Code which relates to distilled spirits (alcohol).
>
> DISTILLED SPIRITS
>
> The Internal Revenue Code (26 U.S.C., Section 5002) defines distilled spirits as that substance known as ethyl alcohol, ethanol, or spirits of wine, including all dilutions and mixtures thereof, from whatever source or by whatever process produced..."

Specifically, the following is an excerpt from the Internal Revenue Code (26 U.S.C., Section 5002 (A) 6:

> DISTILLED SPIRITS
>
> "(a) General Definition - The terms "distilled spirits", "alcoholic spirits", and "spirits" mean that substance known as ethyl alcohol, ethanol, or spirits of wine, including all dilutions and mixtures thereof, from whatever source or by whatever process produced, and shall include whiskey, brandy, rum, gin, and vodka."

These two references to laws and regulations that have been enacted by Congress and are being enforced by the Department of Treasury, are a contradiction to the Customs' interpretation of alcohol. These definitions clearly state that alcohol is alcohol "including all dilutions and mixtures thereof, from whatever source or by whatever process produced, and shall include whiskey, brandy, rum, gin and vodka." (beverage alcohol).

In closing, Congress should enact legislation (H.R. 1720, H.R. 1566, H.R. 1567) to declare null and void the rulings issued by the Customs in its letters concerning the eligibility of certain fuel-grade ethanol for duty-free entry under the Caribbean Basis Economic Recovery Act and the Generalization System of Preferences and that 200 proof alcohol imported from a beneficiary country, but derived from 150-190 proof alcohol produced in a non-beneficiary country, is not eligible for duty free entry and that 200 proof alcohol is not a new or different article of commerce compared with 150 or 190 proof alcohol and that the process by which 200 proof alcohol is produced from 150 to 190 proof alcohol is not a substantial manufacturing process. The continuing development and possibly the total existence of the United States domestic fuel ethanol industry lies with the consideration of this issue by Congress.

Sincerely,

KENTUCKY AGRICULTURAL ENERGY CORPORATION

Jack N. Wade

Jack N. Wade
Vice President/Secretary

JNW:jh-113

bcc: Mr. Eric Vaughn
Renewable Fuels Association
499 South Capitol Street
Suite 420
Washington, DC 20003

STATEMENT OF EUGENE T. ROSSIDES, COUNSEL, ON BEHALF OF LIGA AGRICOLA INDUSTRIAL DE LA CANA DE AZUCAR OF COSTA RICA

On behalf of our client, Liga Agricola Industrial de la Cana de Azucar ("LAICA") of Costa Rica, we submit this statement to express our extreme concern with regard to several legislative proposals, specifically H.R. 1566, 1567, 1720, 4094, which we believe could undermine the integrity of the Caribbean Basin Initiative ("CBI"). LAICA is a non-profit corporation whose predecessor was established by Executive Decree in 1940 and which was reconstituted as LAICA by the Costa Rican Legislative Assembly in 1965. Its board is composed of appointive representatives of the Costa Rican Government and elective representatives of the industry's 32 sugar mills and 9,000 independent cane growers. All mills are either privately owned or cooperatives except for one Government owned mill.

Among LAICA's major directives is the maintenance of a viable social as well as financial equilibrium among all the sugar growers and mill owners. Accordingly, the proceeds of the anhydrous export sales are allocated among all the growers and owners on terms similar to those employed for the liquidation of white and raw sugar, and blackstrap molasses.

LAICA finances a major portion of Costa Rica's sugar crop. It handles the domestic distribution of the country's white sugar and molasses production through a wide ranging network of its own warehouses. And it arranges for and controls the export of all the country's raw sugar and anhydrous ethanol production through the bulk mechanical loading facility and tank terminal it owns and operates at Punta Morales.

In 1985, LAICA requested and received a favorable ruling from the U.S. Customs Service with regard to whether azeotropic distillation of non-CBI 190 proof ethyl alcohol to 199+ proof ethyl alcohol in Costa Rica would qualify under the Caribbean Basin Economic Recovery Act (CEBRA) "substantial transformation" standard. The Customs Service stated in response to LAICA's specific inquiry as well as to those from other parties that such ethanol would qualify. See, e.g., Customs Service Decision No. 553849HS issued November 19, 1985. On the basis of those rulings, LAICA entered into contracts to purchase imported hydrous ethanol to distill in the fermentation and azeotropic distillation plant annexed to the raw sugar mill at CATSA. Completed in 1981 at a cost of 13 million U.S. dollars, this plant has a daily production capacity of 80,000 gallons of anhydrous ethanol. In 1985 it produced some 3,925,000 gallons which LAICA exported to the United States.

Moreover, in good faith reliance on the continuing viability of the CBI ethanol program and the encouragement of the U.S. Embassy in Costa Rica, the sugar mill Taboga in April 1985 contracted for the purchase and construction of a new 5 million dollar (U.S.) annexed fermentation and azeotropic distillation facility. This fully integrated 40,000 gallon a day ethanol plant will be completed and ethanol production will begin by March 15, 1986.

And finally LAICA itself completed a study in the latter half for 1985 for the construction of an azeotropic distillation column and attendant facilities at its raw sugar terminal at Punta Morales, Costa Rica. Authorized by and financed by the entire Costa Rican sugar industry, this distillation facility should commence operations on or about April 1, 1986 with a daily production capacity of 64,000 gallons of anhydrous ethanol. Costs of the distillation column and the attendant pipe lines, pumps and storage tanks to service Costa Rica's ethanol terminal at Punta Morales amount to 6 million U.S. dollars.

The Punta Morales distillation column provides the Costa Rican sugar industry with the necessary diversification and flexibility required to remain a viable economic and social force in the country. Sugar is a vital part of the agricultural strength of Costa Rica, and it is that strength which has traditionally provided the country with much of its political stability and democratic values.

In testimony before this Committee, representatives of the U.S. ethanol industry have fostered the misconception that azeotropic distillation of hydrous ethanol is a simple drying-out process that neither requires substantial capital investment, nor provides employment opportunities. LAICA wishes the process were so simple. Azeotropic distillation of hydrous ethanol into fuel grade ethanol is a complex chemical process requiring large investments in sophisticated equipment. The U.S. Customs Service, presumably a more objective analyst of the process than the U.S. ethanol industry, reviewed the evidence and concluded that it represents a "substantial manufacturing operation" that results in a "new and different article of commerce."

The U.S. industry seeks to change that determination legislatively. No doubt there are other U.S. industries that would like to amend CEBRA or alter Custom's CBI rulings so as to provide their industries with protection from newly competitive Caribbean products. Other industries are certainly capable of making similar arguments that the CBI products with which they compete should consist exclusively of CBI-produced component parts. In creating the CBI program, Congress and the President made an assessment, however, that the national interest in providing economic support to the struggling CBI nations would take priority over the interests of particular domestic industries. While certain products were specifically excluded from CBI treatment when the CEBRA was enacted, ethanol was not among them.

If the U.S. government decides to go back on its pledge to the CBI countries and to overturn the Customs Service's rulings, there should be a grandfathering of those projects in production and those under contract and in substantial construction. Indeed, anhydrous ethanol distilled from those plants should be permitted duty-free entry into the United States for as long as the CEBRA is in existence.

In summary, special interests should not be permitted to undermine the CBI program. If Congress revises CEBRA every time a special interest group opposes the entry of a CBI product, investors, such as those in the Costa Rican sugar industry, are going to look elsewhere. To change the rules now is not only unfair to those CBI countries, but will undermine what the U.S. is trying to achieve in the region over the long run.

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February 11, 1986

Honorable Sam M. Gibbons
Chairman - Trade Subcommittee
Ways and Means Committee
1111 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman and Members of the Committee:

My name is Thomas B. Evans, Jr., and I am a partner in the law firm of Manatt, Phelps, Rothenberg, Tunney & Evans. Our firm represents the interests of the Government of Jamaica here in Washington. I am submitting these comments on behalf of the Government of Jamaica in opposition to certain provisions of H.R. 1566, 1567, and 1720.

I do not doubt the well intentioned goals of the provisions of these bills that exclude ethanol produced with feedstocks not secured within the CBI from duty free treatment under the Caribbean Basin Economic Recovery Act (CBERA). We share the goal of using 100% Caribbean feedstocks to produce the ethanol exported to the United States by Jamaica. However, from a practical standpoint, this goal is virtually impossible to meet at the present time. If this opportunity to utilize non-Caribbean feedstocks as an interim step towards the development of a fully integrated ethanol market is precluded by these bills, one of the few opportunities to revitalize the Jamaican economy will be lost. I would urge the Committee to strongly oppose these measures because of the serious implications their passage would raise both for the economic and political stability of Jamaica and for U.S. security interests in the region.

The Caribbean Basin Initiative is intended to advance economic cooperation between the United States and the nations of the Caribbean Basin and is designed to promote both short term and long range economic development in the Caribbean Region. The central mechanism for achieving these goals is the CBERA. Under the CBERA, eligible articles manufactured in Caribbean nations may be entered into the United States free of duty. It is this duty free access to the large U.S. consumer markets that provides the major incentive for both local and foreign private sector investment in the industrial infrastructure of Caribbean nations. Thus, the success of CBERA and the entire CBI program rests primarily on private sector initiative; initiative which is contingent upon some degree of certainty that there will be a return on investment. Recognizing this, the U.S. Congress intended CBERA to provide "the most favorable and secure long term access possible to the U.S. market."

A cornerstone of Jamaica's economic revitalization is the expansion of its ethanol production capabilities. In light of great potential for the cultivation of Caribbean feedstocks, the 150 million gallon shortfall in U.S. ethanol demand experienced in 1985 and the duty free access provided ethanol under the CBERA, the Government of Jamaica was hopeful that it would enjoy the fruits of foreign investment in the development of a vibrant Jamaican ethanol market.

Unfortunately, because of perceived competition from potential Caribbean ethanol operations, U.S. ethanol industry representatives are now strongly supporting the Leach and Durbin bills in an effort to overturn the duty free access provided ethanol under CBERA. These bills have been introduced at a time when Jamaica is beginning to realize benefits from the development of their ethanol capabilities. In 1985, Tropicana International, Ltd. became the first U.S. corporation to make an investment in the development of the Jamaican ethanol industry since the enactment of the CBERA. Prior to investing in its plant in Kingston, Tropicana sought and received a private letter ruling from the United States Customs Service which affirmed that the dry ethanol produced by that plant would qualify for duty free entry into the United States under the CBERA. On November 19, 1985, the U.S. Customs Service affirmed their earlier ruling, noting specifically that the azeotropic distillation of ethanol in a beneficiary country is a "substantial transformation" of the product, resulting in a "new and different article of commerce" and is thereby entitled to duty free treatment. The U.S. ethanol industry's regulatory appeal of this ruling has since been denied.

In reliance on these affirmations of sound customs law, Tropicana invested $5 million* in their ethanol processing facility in Kingston, Jamaica. Tropicana estimates that to date it has infused $7,552,000 directly into the Jamaican economy. In addition, it employs 67 full-time Jamaican workers, and now spends $1,000,000 per month to operate its plant.

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*All figures in these comments are in U.S. dollars

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The Government of Jamaica welcomed Tropicana's investment in the country as the first step in the private sector development of the Jamaica ethanol industry. However, at the same time, Jamaica fully recognizes that the objectives of the CBERA cannot be met by the development of dehydration facilities without the concomitant development of the capacity to provide these facilities with 100% Caribbean feedstocks. Tropicana has indicated that it fully intends to cultivate feedstocks in Jamaica as well as elsewhere in the Caribbean to eventually replace the Spanish wine stocks now being processed in Tropicana's Kingston plant. On February 3, 1986, the Government of Jamaica announced that it would permit Tropicana to acquire a sugar cane plantation presently owned by the Government for the production of ethanol feedstock. The substantial investment and the employment opportunities that will be produced from the rehabilitation and operation of this project will produce positive economic benefits for Jamaica and the entire Caribbean region.

The Government of Jamaica and the state petroleum company, Petrojam, is also committed to the development of a fully integrated ethanol project that will eventually utilize 100% Jamaican feedstocks. Like Tropicana, Jamaica relied on U.S. law and interpretations thereof and invested $2 million in the development of the infrastructure to accommodate a dehydration facility capable of processing 40 million gallons of wet ethanol annually. Jamaica has also ordered equipment to build the dehydration plant from a U.S. supplier, involving a capital commitment of an additional $2 million. Jamaica will rehabilitate the sugar factory and 14,000 acre cane estate at Bernard Lodge, an area in close proximity to the Petrojam refinery in Kingston. Bernard Lodge has not been operational since the collapse of the sugar market and substantial rehabilitation is now required if it is to be used for the production of ethanol feedstocks.

When fully operational, Bernard Lodge will provide all of the feedstocks for the dehydration facility. The rehabilitation of the factory and the estate for this purpose will result in 3200 direct jobs, 200 temporary construction jobs, and approximately 15,000 indirect jobs, a substantial benefit to a country experiencing chronic unemployment. In addition to producing the feedstocks to be used in the dehydration facility, the Bernard Lodge project will generate a number of important by-products, including methane, 4.5 megawatts of electricity, the evolution and recovery of carbon dioxide for use locally and for export, and the production of animal feeds. The Government of Jamaica looks to the Bernard Lodge project as one of the major opportunities to replace the foreign capital the country lost as a result of the collapse of the bauxite market.

However, it will take an investment of $20 million over a five year period to refurbish the sugar cane fields and the factory at Bernard Lodge. Jamaica does not have the funds available to make such a substantial investment at the present time. Instead, by mid-1986, Jamaica proposes to begin processing 40 million gallons of wet ethanol in their Kingston facility, 9 million of which will be supplied from domestic production. During this rehabilitation period Jamaica will use the foreign exchange it receives from ethanol exports to fund the rehabilitation of Bernard Lodge. As the rehabilitated cane crop reaches maturity, Jamaica will replace foreign feedstocks with domestic supplies. At the end of the five year period, the Kingston refinery will be processing 100% Jamaican feedstock. When this and other fully integrated facilities like it are in operation in Jamaica and elsewhere in the Caribbean, the potential investment in the Caribbean envisioned by the U.S. Congress when it passed CBERA will be finally realized.

None of these positive economic developments will occur if the provisions of the Leach or Durbin bills precluding duty free treatment for Caribbean processed ethanol are passed. Instead, a clear message will be sent to potential investors that if a project in the Caribbean becomes successful, they should expect their U.S. domestic industry counterpart to seek protection from Congress against any competition for their U.S. operation, be it real or perceived. Such a realization will effectively prevent the possibility of any real success for the CBERA and the CBI generally. This result would be particularly disappointing in the case of ethanol in light of the shortfall now being experienced in the U.S. ethanol market, which will increase substantially as EPA continues to phase lead out of gasoline. If the domestic ethanol industry can preclude access to the U.S. market under these circumstances, no prudent investor will consider the Caribbean for investment in operations producing a product in less demand.

The Leach and Durbin bills are predicated on the conclusion that the development of dehydration facilities in the Caribbean is not the type of investment envisioned by the CBERA. However, the economic realities of the region are such that if the Jamaica ethanol industry is to be developed to the point where it can help revitalize the country's economy, these dehydration facilities must be employed as an interim step towards a fully integrated operation. Jamaica relied in good faith on U.S. law and the unequivocable interpretation of that law to invest in this necessary first step. It would be tragic indeed if the Congress were to now change that law and thereby undermine the very purpose for which the CBERA was established.

Sincerely,

Thomas B. Evans, Jr.

Thomas B. Evans, Jr.

STATEMENT OF THE NATIONAL ASSOCIATION OF WHEAT GROWERS IN SUPPORT OF H.R. 1566, H.R. 1567, AND H.R. 1720

This statement is offered in support of H.R. 1566, H.R. 1567, and H.R. 1720 on behalf of the National Association of Wheat Growers. Located in Washington, D.C., the National Association of Wheat Growers represents 17 affiliated State associations and 65,000 commercial wheat growers representing all classifications of wheat. The National Association of Wheat Growers has represented the nation's wheat farmers for 35 years and has earned a reputation as one of the foremost national associations concerning issues affecting American farm commodities.

According to a Purdue University report issued only last month, the domestic fuel ethanol industry used more than 220 million bushels of domestically-raised corn in 1985. The additional demand for the corn necessary to produce ethanol has increased the market price of corn by nearly 10 cents per bushel. Based on estimated 1985 domestic production of 8.5 billion bushels, the demand for corn from domestic fuel ethanol production increased the value of domestic corn by $85 million last year. This is an enviable record and one the American wheat farmer is very much aware of.

As the foregoing circumstances indicate, it cannot be denied that the vitality of the domestic fuel ethanol industry significantly benefits our close cousin, the American corn farmer. While we certainly lend our support to the pending legislation because of the significant salutory effects it will have on the domestic corn farmer, we also wish to bring to the attention of Congress that the American wheat farmer also has a significant interest in the continued health and well-being of the domestic fuel ethanol industry.

Although most domestic fuel ethanol is currently produced from corn, other agricultural commodities also can be used in the production of ethanol -- and have in fact been used -- including wheat, grain sorghum, and potatoes. Virtually any farm product containing sugar or starch can be used as a feedstock in the production of ethanol.

Moreover, as more corn is devoted to ethanol production, values increase for other agricultural commodities which are viable substitutes for corn both in the production of ethanol and as commodities. According to an 1985 study by the Center for National Food and Agricultural Policy, ethanol production -- in addition to increasing each 100 million bushels of corn it uses by 15 cents per bushel -- also increases wheat values by

6 cents per bushel. This study points out that if 20 percent of the nation's corn crop were used annually in the production of ethanol, corn prices would be $1.61 per bushel higher and wheat prices would be $1.04 per bushel higher.

It is for therefore readily apparent that the stimulation and growth of a strong domestic fuel ethanol industry makes for sound agricultural policy as well as good energy policy.

The National Association of Wheat Growers concurs in the comments of the supporters of the pending legislation with respect to the injury being caused by the importation of fuel ethanol in circumvention of U.S. import tariffs and duties. The American wheat farmer is also currently bearing the burden of many unfair trade practices that are severely damaging the American farm economy.

The unwise and unsound determinations made by the U.S. Customs Service regarding the importation of fuel ethanol should be legislatively overturned by the U.S. Congress and the domestic fuel ethanol industry should be given the opportunity to operate in accordance with longstanding federal energy and agricultural policy.

At the recent national convention of the National Association of Wheat Growers, ten resolutions were passed by our membership regarding use of ethanol as an alternative energy supply, including:

-- "NAWG supports an extensive advertising and promotion program for ethanol to focus attention on ethanol's benefits to agriculture, our balance of trade, employment, local capital investment, and reduced oil and ethanol imports."

-- "NAWG supports continuation of and an increase in State and Federal ethanol fuel tax exemptions."

-- "NAWG supports the diversion of CCC surplus stocks into ethanol production."

-- "NAWG supports restoring energy credits for the construction of ethanol plants."

The domestic fuel ethanol industry has created thousands of jobs and billions of dollars of increased domestic economic activity; it has substantially benefitted the American agricultural industry by significantly increasing the demand for agricultural commodities; it has reduced agricultural commodity surpluses; it has saved the federal government millions of dollars in deficiency payments to farmers, storage fees, and loan expenses; it has improved the U.S. balance of trade; it has generated tax revenues; it has provided environmental benefits; and it has given the country a viable alternative fuel source.

For the foregoing reasons, the National Association of Wheat Growers firmly supports the prompt passage by the House Ways and Means Committee of H.R. 1566, H.R. 1567, and H.R. 1720.

STATE OF NEBRASKA
NEBRASKA GASOHOL COMMITTEE
301 Centennial Mall South, P.O. Box 94831, Lincoln, Nebraska 68509-4831
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ROBERT KERREY, GOVERNOR

TODD C. SNELLER, ADMINISTRATOR

GASOHOL
"FOOD AND FUEL FOR THE FUTURE"

FEB 10 1986

February 5, 1986

Joseph Dowley,
Chief Counsel
Committee on Ways & Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Dowley:

The Nebraska Gasohol Committee wants to be on record in support of HR 1566, HR 1567 and HR 1720. These bills require that the sixty cent per gallon tariff on imported ethanol be assessed against fuel ethanol imports. This tariff is frequently avoided by adding small amounts of petrochemicals in order to qualify under T.S.U.S. classifications which have tariff assessments significantly lower than sixty cents per gallon. The tariff is also avoided by dewatering hydrous ethanol in countries which qualify for duty free entry as the result of the C.B.E.R.A. Ethanol produced in the Carribean Basin was intended to be eligible for duty free entry. However, most ethanol currently shipped from the Carribean Basin appears to have been dewatered but not produced there. This dewatering scheme will discourage significant investment in the Carribean Basin. The proposed legislation would correct and clarify the intent of C.B.E.R.A. regarding ethanol production.

Enactment of these bills would also reduce the current exposure of the U.S. Treasury. Circumvention of applicable tariffs represents an unnecessary drain on Treasury revenues.

Circumvention of applicable tariffs also reduces the potential for using U.S. agricultural products for fuel ethanol. Financial institutions have also expressed concern about the possibility of duty free ethanol imports flooding the U.S. market. Because of the adverse impact of tariff circumvention, the Nebraska Gasohol Committee supports HR 1566, HR 1567 and HR 1720. As an agency of state government, the Nebraska Gasohol Committee is responsible for assisting private sector efforts to develop ethanol plants.

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Joseph Dowley
Page two
February 5, 1986

Our efforts are undermined whenever duty free fuel ethanol enters the U.S. Enactment of these bills will eliminate most of the current problems associated with duty free imports.

Sincerely,

Todd C Sneller

Todd C. Sneller, Administrator

Ralph E O'Connor

Ralph E. O'Connor, Chairman

TCS/lt

Statement of
New Energy Company of Indiana

Supporting H.R. 1566, H.R. 1567, and H.R. 1720

Before the Subcommittee on Trade
House Ways and Means Committee
United States House of Representatives

February 13, 1986

New Energy Company of Indiana strongly supports the enactment of H.R. 1566, H.R. 1567, and H.R. 1720. These bills are necessary to close certain loopholes which materially threaten the viability of the domestic ethanol industry and in our opinion subvert the intent of the Carribean Basin Economic Recovery Act (CBERA).

New Energy is the owner of the largest grassroots ethanol production facility in the United States. New Energy's plant, located in South Bend, Indiana, converts annually 22 million bushels of corn into 60 million gallons of ethanol, 200,000 tons of dried distillers grains and solubles and 145,000 tons of carbon dioxide. The plant is powered by its coal fired generating facility. For your reference, an aerial photograph of the facility is attached.

The construction of the facility commenced in October, 1982 and was completed in October, 1984. During this period, over 800 construction workers were employed on site. The total cost of this project was approximately $185,000,000.

The principal sources of funds were $40,000,000 in equity, capital and $140,914,000 in bank loans - 90% of which are guaranteed by the United States Department of Energy. New Energy is the recipient of the largest loan guarantee in the history of the U.S.

Alcohol Fuels Program and the only project currently in production.

Our plant represents a dramatic utilization of technological expertise and utilizes the equipment necessary to produce ethanol in the most cost effective and efficient manner.

Given the substantial capital invested in this project by U.S. investors, lenders and the commitment of the U.S. Department of Energy, we are most concerned about issues before your Committee which, if not addressed in an expeditious fashion, could jeopardize and undermine the economic viability of New Energy's project and the entire U.S. ethanol industry. Specifically, we are referring to the Customs Department's ruling that certain dehydration facilities utilizing a basic azeotropic distillation process qualifies for duty free treatment under the CBERA, and to certain tarrif classifications that permit ethanol when blended with various other chemical components to escape the duty on imported fuel ethanol.

First, the Customs Service ruling in question concludes that a simple dehydration process qualifies as a substantial transformation and creates a new article of commerce under the CBERA. This decision is incorrect and a gross misinterpretation of the intent and purpose of the CBERA.

While New Energy understands and generally supports the goals and policies of the CBERA, it is critical that the mandates of the Congress and the President be implemented in a manner intended by the Program. The purpose of requiring the substantial transformation test is to prevent clever developers from jumping through loopholes to obtain CBERA duty free treatment.

Quite frankly, it is inconceivable that the Customs Service can conclude that the mere removal of water in a dehydration facility to upgrade the proof level of 95% pure ethanol to 99% pure ethanol is a substantial transformation. To illustrate the untenable and inequitable nature of this conclusion, please refer to New Energy's aerial photograph. Please note the distillation column. This piece of equipment represents the entire Tropicana ethanol production facility. For a capital cost of approximately 5 million dollars, (compared to New Energy's 185 million) the Jamaican drying facility can produce 20 million gallons of ethanol (compared to New Energy's 52.5 million). As the premier U.S. project that was awarded a loan guarantee from the Department of Energy after substantial competition from many other projects, we ask that you please consider the difference between a bona-fide ethanol production facility that is able to transform corn or other raw materials into a new article of commerce to a single dehydration column that merely upgrades ethanol produced elsewhere.

Clearly, when Congress created the CBERA program, its intent was to stimulate capital investment in this region so as to utilize Caribbean labor and raw materials. Certainly the construction of complete ethanol facilities capable of truly transforming CBI sugar cane and other raw materials into ethanol is a worthy policy goal and wholly in keeping with the spirit and letter of the CBERA program. However, the assembly of a dehydration facility to act as a dryer of highly subsidized surplus Spanish or Brazilian produced ethanol is simply a clever attempt to circumvent the U.S. duty on foreign produced ethanol without providing any meaningful benefit to the Caribbean economy.

If this ruling is not revoked or reversed as to this and all future dehydration facilities, we will have permitted the CBERA to become a conduit for funnelling Brazilian ethanol into the United States in massive quantities and without regard to the U.S. duty on foreign ethanol. If this happens, the rapid proliferation of CBI dehydration facilities will certainly jeopardize the substantial capital invested in the U.S. This result would be a tragic consequence given the enormous contribution the domestic ethanol industry provides to our depressed agricultural economy, to high unemployment areas of the Midwest, and to the enhancement of our national energy security.

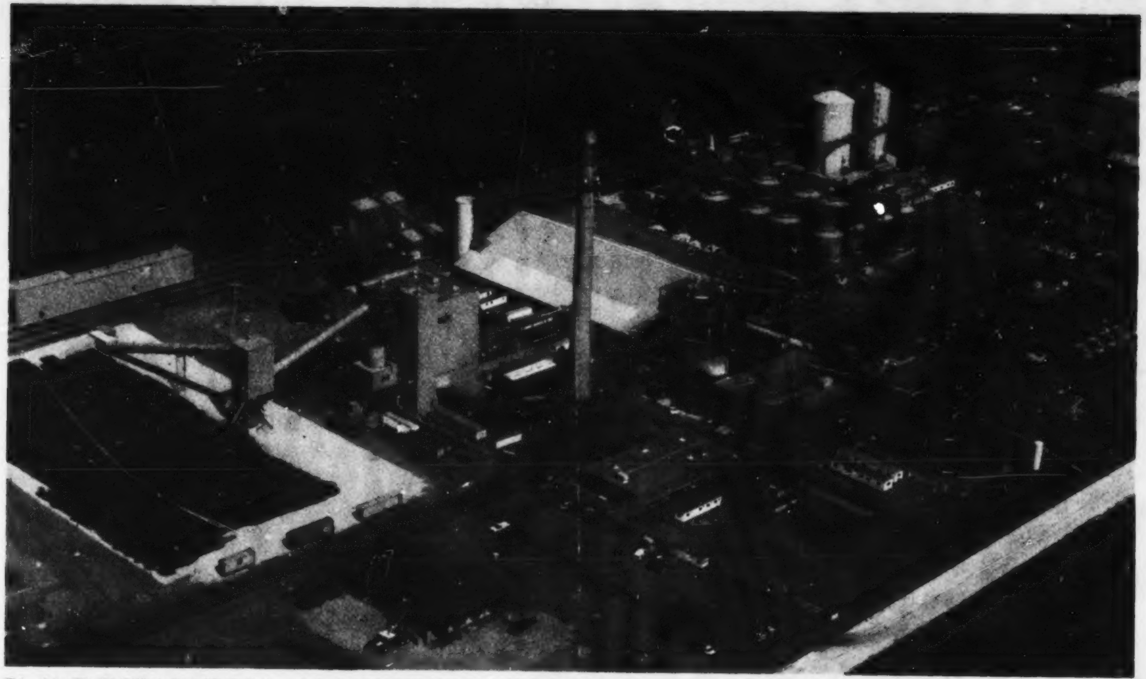
I want to stress the importance of clear and timely action by the Congress. As a Company that has invested almost 200 million dollars in reliance upon government policy, regulations and laws, New Energy understands the inequity that a change or reversal of policy can have upon companies that have in good faith relied upon government decisions. In this situation, it is obvious that Tropicana, like many of us in the ethanol industry, has made an investment decision in reliance upon a governmental policy determination. Certainly, New Energy can appreciate the need for consistency of government action and the need to protect businesses from inconsistent and contradictory policies that can jeopardize investments. Therefore, while we understand that some equitable solution such as an extremely rapid phase out period for duty free treatment and strict volume limits be considered with respect to this single situation, it is imperative that this argument of "justifiable reliance" be eliminated for all future developers contemplating similar projects in the CBI.

This can only be achieved by enactment of the legislation before you. The failure to act decisively and expeditiously to close this loophole runs the great risk of destroying a major U.S. industry and perverting the goals and policy of the worthwhile CBI plan.

The second issue addressed by the legislation before your committee relates to loopholes in the tarrif structure that permit ethanol blends and mixtures to escape the import duty on fuel ethanol. During the past year, clever traders have been able to exploit loopholes in the U.S. tariff schedules and import over 40 million gallons of Brazilian fuel ethanol into the U.S. without payment of the duties applicable to ethanol for fuel use. In this instance, ethanol has been mixed with toluene to come in as a duty free mixture. More recently, certain letter rulings from the Customs Service were issued that afford duty free treatment of ethanol has been mixed with ethyl benzoid xylenes because of a quirk in the Generalized System of Preferences. Each of the above schemes involve tens of millions of gallons of ethanol. Therefore, the existence of Brazil's massive inventory and Brazil's willingness to export fuel ethanol through traders taking advantage of highly questionable schemes has created a substantial threat to the domestic ethanol industry.

The fact that our industry, after numerous legal proceedings, has not yet been completely inundated is little solace. Our customers see Brazil's inventory. They also see the prospects of huge profits to be made through the import schemes discussed above. The continued aggressive use of loopholes to bring Brazilian ethanol into our marketplace duty free, whether by mixtures, or via CBI dehydration facilities, materially threatens New Energy and the U.S. ethanol industry.

The existence of these loopholes cost the U.S. Treasury tarrif revenues, threaten the U.S. industry and provide huge profits to a small number of companies that have not made a substantial capital commitment to the ethanol industry. Accordingly, we urge the favorable and expeditious enactment of this legislation.



PLANT DEDICATION • NEW ENERGY COMPANY OF INDIANA • OCTOBER 24, 1984

Statement of
George D. Robey, Director of Special Projects
Ohio Farm Bureau Federation
Washington D.C
February 6, 1986
Before the Trade Sub-committee of
The Ways and Means Committee of
The U.S. House of Representatives

Thank you for permitting us to express views from farmers about legislation you are considering today. My name is George D. Robey. I am the Director of Special Projects for the Ohio Farm Bureau Federation. Our wholly owned-subsidiary, the Ohio Farm Bureau Development Corporation, joins other domestic fuel ethanol producers asking for fair treatment in international trade practices in order to compete, without penalty in markets developed by us in America. If successful, this domestic ethanol industry will benefit farmers whom we represent, as well as helping all other corn farmers in this nation. We support House Resolutions 1566 and 1567 by Representative Jim Leach of Idaho and House Resolution 1720 by Representative Richard Durbin of Illinois.

The Ohio Farm Bureau Federation was founded in 1919 for the purpose of representing, advancing and protecting farm interests in Ohio by centralizing into a single organization the strengths and influences of the state's county Farm Bureaus. Our membership this year will reach beyond a record level of 96,548 families in 1985. The Ohio Farm Bureau is associated with the American Farm Bureau Federation, whose national membership exceeds 3.3 million families. The Ohio Farm Bureau provides numerous services to its members, including insurance, legislative services, public affairs, commodity services, marketing, and development of numerous special projects on behalf of farmers.

Consistent with the objectives of the organization, the Ohio Farm Bureau has participated actively in the development of fuel ethanol production in Ohio because of its potential to improve corn and grain marketing. These efforts were commenced when corn and grain markets were devastated by the grain embargos. Beleaguered Ohio farmers turned to us for help. In response, the Ohio Farm Bureau engaged the services of engineering firms to study the feasibility of projects that could convert corn into ethanol. The studies they produced indicated the potential of converting 24 million bushels of Ohio corn into 60 million gallons of ethanol each year. This amount of corn equals approximately 10 percent of the available corn grown in Ohio.

As a result of these findings, the Ohio Farm Bureau became involved in two projects. First, through the Ohio Farm Bureau Synfuels Investment Company, we became a 20 percent owner of the large South Point Ethanol plant in South Point, Ohio.

Second, through its wholly-owned subsidiary, the Ohio Farm Bureau Development Corporation, we developed and constructed a small 200,000 gallon-per-year fuel ethanol plant in Mt. Sterling, Ohio for the purpose of demonstrating to farmers that they, in small groups, could build, own and operate plants of a similar small magnitude on an economically feasible basis for processing corn into ethanol. This plant was built with approximately $700,000, some of which was provided by the Ohio Departments of Agriculture and Energy.

During its first four years, the Mt. Sterling plant operated on an experimental basis, using many different feed stocks and literally hundreds of different processing techniques to create anhydrous ethanol. Perhaps the most unique achievement of the small plant is its successful use of cyclohexane, rather than benzene, to dry ethanol into an anhydrous state. Also, the plant has experimented with producing fuel ethanol from wastes from a food processing plant being threatened with closure by the EPA because of its inability to dispose of the wastes.

After years of experimentation and demonstration, the Mt. Sterling plant made its first commercial sale of fuel ethanol in February, 1985. It was anticipated that the plant would begin operating on a commercial basis in an effort to pay back the funds which were expended on it. However, the commercial viability of this plant fell into jeopardy because of the depressed market prices for fuel ethanol in Ohio caused by the marketing of fuel ethanol imported from Brazil at cut-rate prices.

The plant's first commercial sale of fuel ethanol was made at a price of $1.42 per gallon. This price is far lower than the prices that were generally prevailing in Ohio before the appearance of Brazilian fuel ethanol. The Mt. Sterling plant simply cannot operate profitably with prices at this level. By contrast, a top-off price in Ohio had been $1.57 per gallon, except in the case of one company which apparently continued to sell Brazilian products at lower prices. Their apparent access to Brazilian ethanol has depressed prices and given them a market advantage even among their peers.

These conditions were hindering our efforts to negotiate contracts for the sale of our fuel ethanol. For example, we discussed selling a major portion of the plant's fuel ethanol output to Certified Oil Company of Columbus, Ohio. Certified has been a major consumer and distributor in Ohio of fuel ethanol from Brazil. Since Certified had access to large quantities of Brazilian fuel ethanol at low prices, it was and probably still is willing to purchase our fuel ethanol but at comparable prices. We cannot sell our product at prices caused by unfair flow of dumped Brazilian product, subsidized and/or tariff-free, and make a profit. We believe the various legislation under your consideration today would close various loopholes through which Brazilian imports and resulting cut-rate prices have damaged U.S. markets. This threatens farmers' income as they depend on this ethanol market to purchase their corn.

One must analyze these losses beyond the actual cash loss at the ethanol manufacturing plant level, which is damaging in itself. Each gallon price loss multiplied by 60 million gallons (as at South Point) or 200,000 (gallons at Mt. Sterling) has its immediate penalty on a relative basis. The economic base in a smaller plant, such as in Mt. Sterling, has a drastic and rapid effect.

This is felt by small sensitive investors often terrified over big government whims such as a blow dealt recently by the U.S. Customs Services to permit Brazilian ethanol to compete unfairly. Ethanol was permitted by the U.S. Customs Service to flow into our country tariff-free for a 60-day period to November 1, 1985 to five favored companies including ones who sell in our marketing area.

Another loss felt directly by the farmer is that for every bushel of corn lost to ethanol from Brazil, made from sugar cane, it's a bushel not used or sold in this market. The farmer must then store it at a cost of about 15 cents per bushel. Selling the corn for ethanol earns about 10 cents additional per bushel. This is documented by a study from Purdue University released late last year and completed by Dr. John R. Umbeck. To quote:

"1. Virtually every economist and industry analyst agrees that the additional demand for the corn necessary to produce ethanol has increased the market price of corn when this price has been free to fluctuate. My estimate is that the price of corn will be 9.9 cents per bushel higher than it would have been without domestic ethanol production.

2. Using projected 1985 corn production figures and assuming the market price of corn is free to fluctutate, the value of the United States corn crop will be $849,000,000 higher than it would have been without domestic ethanol production.

3. When the market price of corn is below the government support price and prices are not free to move, each bushel of corn used in ethanol production reduces government purchases and storage by one bushel. The estimated 222 million bushels used in 1985 will save taxpayers over $623,000,000 this year alone.

4. Even after subtracting the tax revenues lost through the six cent per gallon exemption on blended gasoline, the net savings to the federal government in agriculture support costs is over $227,000,000 in 1985. This net savings to the government could be used to reduce taxes or lower the deficit."

And directly related to our cases today, "5. Because ethanol produced in other countries and sold in the U.S. is eligible for tax exemptions, we are subsidizing foreign ethanol. Replacing these imports with domestic ethanol would have saved U.S. taxpayers $118,000,000 in 1985."

The loss of these operations at Mt. Sterling and South Point would be a tragedy for Ohio citizens. Not only would a significant amount of Farm Bureau investment committed to these projects be lost, but the enormous benefits that would be enjoyed by Ohio farmers if such projects were feasible also would be lost. For these reasons, the Ohio Farm Bureau supports fair and proper tariff practices being considered today before your sub-committee at the U.S. House of Representatives.

I will try to respond to any questions that you may have.

PEC **PEKIN ENERGY COMPANY**
P.O. BOX 10 PEKIN, ILLINOIS 61555

February 11, 1986

Statement of Mr. A. E. Stuenkel before the House Trade Subcommittee, Bills, HR 1566, 1567, (Leach) and HR 1720 (Durbin).

I am Arthur E. Stuenkel, President and CEO of Pekin Energy Company, a Joint Venture of Texaco Inc. and CPC International, Inc. We are the second largest manufacturer of fuel-grade ethanol in the United States. Our Company was formed in 1980, soon after the second Arab oil embargo, as part of a national interest to reduce our dependence on foreign oil.

At the time of our conception and operational start-up, the Federal Government had put in place, several incentives for companies, such as ours, to invest the millions of dollars required to build new ethanol facilities. As part of this overall program of national energy independence, a 60¢ per gallon tariff had been placed on imported ethanol. This tariff was imposed, not as a means of penalizing imported ethanol, but rather to neutralize the effect of the federal tax exemptions that imported ethanol enjoys. This action is certainly in keeping with the national interest of developing a domestically-secure renewable energy industry, which uses surplus domestic agricultural crops and reduces dependency on foreign energy sources. The congressional record and the federal register clearly show that it was the intent and will of Congress that all imported ethanol be neutralized from the effect of the Federal Excise Tax Exemption and the Federal Blenders' Tax Credit.

Today, we are in the midst of a farm crisis. The contribution made by the domestic ethanol industry is one of the few bright spots on the agricultural horizon. Previously, most government programs have been aimed at reducing supply; thereby, using precious tax dollars to let needed domestic resources stand idle. The ethanol industry, now as large as the Soviet grain market, returned the investment made in it through additional tax dollars and value-added products.

According to a recently completed study by Professor Umbeck of Purdue University, the effect of the ethanol industry on the U. S. corn market has resulted in an increase in the value of corn by nearly 10¢ per bushel. Based upon an annual production of 8 billion bushels, this represents 800 milion dollars in additional revenues to U. S. farmers. This represents 800 million dollars not being spent by the Federal Government in the form of price supports and additional set-aside programs. This is to say nothing of the additional economic benefits gained by the thousands of people put to work and the economic activity generated by the nearly 700 million gallons per year of ethanol production in the United States.

The domestic ethanol capacity exceeds the demand. For the year, 1985, total U. S. capacity was 900 million gallons. By year end, the total domestic ethanol capacity exceeded 1.0 billion gallons per year.

Reviewing those who are interested in HR 1566, 1567, and 1720, one finds that those interested in passage of these Bills, represent members of government, producers, investors, agriculture, and Caribbean Basin entities themselves. Those opposed constitute a handful of dehydraters and importers, who stand to make large sums of money for relatively minimal investments. It is for the subcommittee to decide whose interests constitute the best national interest.

Ethanol has a place in the American motor fuel picture. Even in this time of dramatically declining world oil prices, America still has a need to ensure a domestically-secure renewable energy resource. Ethanol has helped to break the back of OPEC and is also an environmentally benign clean-burning octane replacement for lead in gasoline. It creates a domestically-secure market for American agriculture and provides a greater economic activity than the amount of investment placed through tax exemptions. Current tariffs do not penalize foreign-sourced ethanol, but merely neutralizes the benefits of this national investment in energy security.

We urge your support of HR 1566, 1567, and 1720. Thank you.

U.S. FUEL ETHANOL PLANTS

COMPANY	LOCATION	ANHYDROUS CAPACITY (000)
Agrinol Inc.	AL	0
National Bio-Fuels (T/A Arkansas Distillers)	AR	500
J.E.W., Inc.	AR	3,000
Golden California Cheese Company	CA	2,000
Whitelightening Fuel Company	CA	2,000
U.S. Gasohol Corporation	CA	10,000
Fermentation Engineering Company	CA	400
Raven Alcohol	CA	10,000
Parallel Products, Inc.	CA	1,000
Baca Food & Fuel	CO	1,500
Cheyenne Fuels Inc.	CO	600
Ag Power of Colorado	CO	1,400
San Luis Valley Protein Energy Corp.	CO	0
Colorado Agri Energy Corporation	CO	4,000
Crowley County Farm Fuels, Inc.	CO	2,000
Colorado Gasahol, Inc.	CO	2,100
Parallel Products, Inc.	CA	5,000
Southern Ethanol (Bio-Chemical Energy)	FL	5,000
Bio-Chemical Energy	FL	2,000
Clinton Southeast Joint Venture	GA	1,500
Syncorp, Inc.	GA	3,000
M.T.J., Incorporated	IA	4,000
Archer Daniels Midland	IA	60,000
Archer Daniels Midland	IA	0
Arcadia Refining Company	IA	1,800
Elgin Alcohol Incoporated	IA	1,500
ADC II	IA	5,000
AGX Limited	IA	2,000
Grain Processing Corporation	IA	10,000
Appropriate Community Tech. Corp.	IA	600
C. M. Inc.	IA	3,500
Idaho Fuels	ID	600
Snake River Ethanol	ID	1,500
J.R. Simplot Company	ID	3,000
Beard Alcohol Farm	ID	500
Janas Farms, Inc.	ID	500
Castle Creek Energy	ID	4,000
CEPO, Inc.	IL	2,000
Southern Illinois Agri Food & Fuels Co-op	IL	750
Archer Daniels Midland	IL	150,000
Illinois Alcohol Fuels and Feed	IL	750
Pekin Energy Co.	IL	70,000
Midwest Grain Products, Inc.	IL	11,000
Archer Daniels Midland	IL	90,000
Greater Rockford Energy & Tech. Corp. (GREAT)	IL	3,000
Vienna Correctional Center	IL	750
Octane Unlimited Distillery	IN	750
Schenly Distillery	IN	7,000
New Energy Company of Indiana	IN	50,000
Midwest Grain Products, Inc.	KS	6,000
High Plains Corporation	KS	10,000
Reeve Agri Energy	KS	1,750
ESE Alcohol, Inc.	KS	750

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Kentucky Agricultural Energy	KY	20,000
National Distillers & Chemical Corp.	KY	0
Whitbread, N.A., Inc.	KY	0
Gulf Star Fuels Associates	LA	7,000
Shepherd Oil Incorporated	LA	25,000
New Orleans Alcohol Corp. (t/a Dixie Brewing)	LA	1,500
Midwestern Companies, Inc.	LA	12,000
Smithfield Fuels	LA	4,000
Shrevport Ethanol Incorporated	LA	2,000
American Fuel Technologies, Inc.	MD	4,500
Michigan Agri-Fuels,Inc.	MI	8,000
Jorritsma Farms	MI	700
World Wide Energy, Inc.	MI	1,500
Hartland Organic Foods, Inc.	MN	1,500
W.D. Fuels	MN	500
Zumbro Valley Alcohol and Feed Co.	MN	1,200
Lakefield Ethanol (MN Alcohol Fuels)	MN	1,500
G & S Gasohol, Inc.	MN	2,000
Kraft, Inc.	MN	1,000
KV Alternatives, Inc.	MN	500
Graf Alcohol	MN	800
Southeast Missouri Distillery	MO	750
A.E. Montana, Inc.	MT	1,850
L.P. Anderson	MT	0
Alcotech	MT	1,500
Dawn Enterprises	ND	11,200
Ainsworth Feed Yards	NE	0
Agri-Fuel Limited	NE	400
American Diversified Companies (ADC I)	NE	11,000
Lancaster Processing Company, Inc.	NE	1,500
Deboer Brothers Renewable Fuel, Inc	NE	1,500
United Alcohol, Inc.	NJ	0
The Midwestern Companies	NM	12,000
West Texas Ethanol	NM	1,200
Nelson Hart Enterprises	NM	1,500
Mountain Development Corporation	NM	2,000
C.F.S. Portales Ethanol Limited	NM	3,000
Energy Fuels Development	NM	10,000
Grain Power Tucumcari Limited	NM	4,500
Tad's Enterprises, Inc.	NV	500
CHEM - I, Incorporated	OH	1,000
South Point Ethanol	OH	60,000
American Fuel Technologies, Inc.	OK	5,000
Union Development Company	OK	600
Owhyee Energy Corporation	OR	600
Little Valley Ethanol, Inc.	OR	0
Publicker Industries, Inc.	PA	20,000
Southern Alleghenies Farmers Ethanol Coop	PA	0
SEPCO	SD	1,000
Colburn Enterprises	SD	2,000
RE-EN-CO, Inc.	SD	500
A.E. Staley Manufacturing Company	TN	40,000
Alcohol Cartel	TX	700

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Lorwen Industries Inc.	TX	5,000
Panhandle Ethanol Producers	TX	600
AFS Research	TX	2,000
Charmic Energy Corporation	TX	0
Golden Technology Corp.	UT	1,000
Weston Grain and Agri Fuels Inc.	UT	2,500
Pinedell, Inc.	VA	6,000
Charles City Energy Company	VA	1,650
Chemical Ethanol Producers, Inc.	VA	6,600
IDICO, Inc.	VA	3,300
Floyd Agricultural Energy Co-Op	VA	7,000
Chemical Ethanol Producers, Inc.	VA	2,600
New Church Energy Associates Limited	VA	1,600
A. Smith Bowman Distillery	VA	5,000
ETOH, Inc.	VA	1,000
Shelburne Leasing	VT	500
Georgia-Pacific Corporation	WA	2,500
American Grain Processing	WA	1,000
Matrix Energy Company	WA	1,000
Pabst Brewing Co, Tumwater Division	WA	700
TCV Alcohol, Inc.	WI	2,100
Grudem Brothers Company	WI	1,500
Universal Foods Corp.	WI	0
Center Valley Fuel Alcohol	WI	1,500

PETRO CARBON
CONSULTING ASSOCIATES, INC.

February 12, 1986

Mr. Joseph K. Dowley
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
Room 1102
Longworth Building
Washington, D.C. 20515

Dear Mr. Dowley:

I would like to express my appreciation for the opportunity to express our position on the bill introduced by Rep. Michel of Illinois, known as the "Ethanol Fair Imports Act of 1986". Our firm is opposed to the passage of this legislation.

This firm is an investor in United States Resources & Chemicals, a United States Virgin Islands corporation. U.S. Resources has recently completed the construction of a small, 12 million gallon per year ethanol plant on St. Croix, in the United States Virgin Islands. If this legislation is passed as proposed, U.S. Resources will be wiped out, and many investors, such as this firm, will also be on the brink of financial disaster.

The U.S. Resources plant, which was ordered in early 1985, and delivered in January of 1986, was made possible through the investment of Americans, into an American firm. The plant was built by Americans in the State of Virginia. It is being operated by Americans, in a territory of the United States. The product that it produces is a product of the United States. The corporation is subject to the U.S. Tax Code. U.S. Chemicals & Resources is a domestic manufacturer, utilizing imported raw materials.

We have been involved in the marketing of alternative fuels since 1979, which is when the last fuel emergency occured in the United States. Many people have forgotten, but it must be remembered that during those trying days, our entire economy was threatened. We had experienced an earlier fuel emergency when the United States was the victim of an Arab oil boycott. It was vital that the United States implement a policy that would put us beyond economic blackmail.

During that last crisis, I was the official in charge of Emergency Fuel Allocation for the State of Arizona. I still vividly remember network T.V. news accounts of a motorist in California who was murdered for cutting in on a gasoline line. I remember the long hours that we put in trying to avoid the same situation in Arizona. At that time, a clear national policy seemed to emerge. The United States had to develop new, efficient, and reliable forms of alternative energy. Alcohol, perhaps mans oldest liquid fuel, was the clear choice as an immediate answer to a crisis which endangered not only our own economic security, but indeed the economic and political security of the world.

In response to the fuel crisis of 1979, the Congress granted tax incentives to the fuel alcohol industry. Those incentives have been increased by the Congress. The tax incentive, it was rightly argued, was needed to develop an almost entirely new industry, in a short period of time. The fuel alcohol industry was developed via tax incentives, and is maintained today via tax incentives.

While the fuel alcohol industry is now well established, it has a long way yet to go. Total fuel ethanol production in the United States in 1985 was 625 million gallons. It is estimated that total production in 1986 could approach 800 million gallons. Many in the industry believe however that the 800 million figure is too optimistic. While the above numbers are impressive, they are dwarfed by the actual gasoline consumption in the United States, and by the potential ethanol consumption in the United States. In 1984 (the latest year with complete figures) 108.5 billion gallons of gasoline was consumed. If the total production of ethanol in the United States was shipped to California, and blended with gasoline, we could not even come close to a legal blend. In fact, the gasoline in California would contain only 5.5% ethanol and 94.5% gasoline. A legal blend contains 10% ethanol, and 90% gasoline.

In spite of this hugh gap between current and anticipated production, one large domestic firm, Archer Daniels Midland (ADM) of Decatur, Illinois, is now doing everything possible to destroy any competition. This includes domestic firms such as ourselves, and foreign competition. ADM today controls the largest share of the domestic market. It is common to hear in the industry that ADM is out to control not only the domestic production and marketing, but foreign production as well. It has been reported in trade journals that while ADM is publicly blasting the Brazilians, that they are "unofficially" negotiating with them, trying to purchase their entire production. It has also been reported that ADM is interested in foreign quotas for ethanol. Included in the quota proposal is that the foreign ethanol would have to come through a domestic producer. I wonder who ADM had in mind for that role? I'm sure that they were not thinking of U.S. Resources & Chemicals.

During the last fuel crisis, ADM could not supply any market outside of the midwest. Here in Arizona for example, marketers paid $2.20 for imported Brazilian ethanol, and were glad to get it. If another fuel emergency were to develop, and past history clearly indicates our vulnerability, ADM would supply only those markets closest to its Iowa and Illinois plants. Indeed, using the California example, if all the fuel ethanol produced in the United States were shipped to Iowa and Illinois, there would be barely enough to blend a legal product. If all the ethanol produced in North and South America were to be blended in the United States, that still would only dent the market.

We built our plant at considerable investment, in complete good faith, under existing law. We adherred to every requirement of the law. We have relied upon the integrity of legislation passed by the Congress of the United States. We obtained a letter ruling from the Custom's Service of the United States, only after we had satisfied the Service that we had indeed fulfilled all the requirements of the law. The legislation that we operate under was intended to benefit American insular possessions. Officials of the United States Virgin Islands have supported us as we established on St. Croix. We worked closely with the Industrial Development Commission of the United States Virgin Islands, and have satisfied all their requirements. We meet all environmental protection requirements. Despite all this, we are faced with a bill, which will retroactively, wipe us out.

Mr. Joseph K. Dowley
Page Three

The proponents of this bill argue that they are saving American jobs from a horde of unseen Brazilians, living in some remote Amazon jungle. Our response is simple. What about those Virginians who built our plant? What about those Americans who invested in our plant? What about those Americans who operate and make their living from our plant? It appears that Rep. Michel is concerned about only those Americans who happen to live in central Illinois.

This legislation, if passed, will destroy an American company, not one based in Brazil. Its true that we are not an Illinois company, but by every definition of the word, we are American. Our investors are American small businessmen, who face economic diaster. If this legislation passes, we will not be able to meet our payment obligations to the Virginia manufacturer. They in turn may not be able to meet their obligations. We would be forced to fire Americans, not Brazilians. What do we tell their families? That ADM wants them to move to central Illinois.

The people of the United States have shown support for the fuel alcohol program through their elected representatives in the Congress. ADM has done everything within its considerable power to eliminate competition, and to gain complete control of the industry. It is up to the Congress to insure that a strong, competitive industry takes shape. Not one dominated by one large, all powerful special interest. It is up to the Congress to implement policy that is fair to all the people of the United States, and not just those who live in central Illinois.

We would sincerely appreciate the support of the committee in defeating this grossly unfair, and uncompetitive legislation.

Sincerely,

Lloyd Vacovsky

Lloyd Vacovsky
President

LV/ss

February 11, 1986

The Hon. Sam Gibbons
Chairman
Trade Sub-Committee
House, Ways and Means Committee
Longworth House Office Building
Room 1136
Washington, D.C. 20515

Dear Representative Gibbons:

Petrojam Limited (a wholly-owned Jamaican Government company) supports the current Caribbean Basin Initiative (CBI) legislation entitling duty-free treatment of ethanol from CBI countries. We also support duty-free treatment of ethanol from non-CBI countries but dehydrated in a CBI country, provided the 35 percent value added criterion is met.

Petrojam has been developing a fuel ethanol project over the past year. Currently, we have constructed approximately US$2 million worth of facilities, and are awaiting delivery of a further US$2 million worth of equipment to complete the dehydration facility. In the Jamaican context, this investment is substantial.

In addition, our parent company, the Petroleum Corporation of Jamaica, is now starting the rehabilitation of a sugar estate (which was about to be closed) for the sole purpose of providing ethanol. This first estate will eventually provide approximately one half of the feedstock for the dehydration plant. This project involves several million dollars worth of rehabilitation and new fermentation/distillation facilities and will ensure the continued employment of workers. Again, the level of investment and employment, in the Jamaican context, is very substantial.

To repeal the benefits of the CBI at this stage would not only be counter to the intent of the CBI to assist countries such as Jamaica, but would cause significant harm to Jamaica in terms of lost investment of money, time and manpower.

Yours very truly
PETROJAM LIMITED

H.J. Fenton
Managing Director

H.R. 2028

To render watches eligible for preferential treatment under title V of the Trade Act of 1974.

H.R. 2029

To amend the Tariff Schedules of the United States in order to eliminate the special marking requirements for imported watches and clocks and components thereof.

Local No.1-J

Amalgamated Jewelry, Diamond & Watch Case Workers Union
133 West 44th Street, New York, NY 10036 • (212) 246-2335

President
Joseph Tarantola
Vice-Pres.
Oswald Gutierrez
Secy.-Treas.
Herbert Johnson
2nd Vice-Pres.
H. Clifford Wilson
Organizer
Pedro J. Ortiz

February 20, 1986

Joseph K. Dowley, Chief Counsel
Committee on House Ways and Means
U.S. House of Representatives, Rm. 1102
Longworth Building
Washington, D.C. 20515

Dear Mr. Dowley:

The watch industry in the United States has been dealt some very heavy blows as a result of imports. Many thousands of workers have lost jobs.

I urge you to consider that the Timex Watch Corporation, some four years ago, employed 4,000 workers in their watchmaking facilities in the United States. Today, since the establishment of their plant in the Philippines some four or more years ago, the Company employs only 1400 workers in our country. This represents a 65% reduction of their American workforce.

Any further reductions in tariffs or duty-free status for imported watches or watch movements would be devastating to American watch workers' jobs.

The loss of American jobs to offshore and foreign establishments producing products for American consumption at the cost of American jobs is an injustice to American workers.

I strongly urge you to use your influence in every way possible to save American jobs.

Three thousand jewelry workers in our local voice our strong opposition to HR2028.

There have been too many American jobs lost to greater profit making. Let's start thinking about people's needs before profits.

We appeal to you and your Committee's sense of fair play and justice for American workers: Defeat HR2028.

Very truly yours,

Joseph Tarantola

Joseph Tarantola, President
Local No. 1-J, Service Employees
International Union, AFL-CIO

opeiu/153

February 13, 1986

Before the
Subcommittee on Trade
Committee on Ways and Means
United States House of Representatives

Statement of the American Watch Association in Opposition to H.R. 2028 and H.R. 2029

This statement is submitted on behalf of the American Watch Association ("AWA") in opposition to two legislative proposals under consideration by the House Subcommittee on Trade:

(1) H.R. 2028 -- a bill to remove watches from the list of products that are proscribed from eligibility for duty-free tariff treatment under the Generalized System of Preferences ("GSP"); and

(2) H.R. 2029 -- a bill to delete the special marking requirements for watches in Headnote 4, Schedule 7, Part 2, Subpart E of the Tariff Schedules of the United States.

The AWA is a trade association of approximately 40 companies organized and doing business within the United States that are engaged in the importation, assembly and manufacture of watches, watch movements and watch products for sale in the United States and world markets. AWA members include the firms that market such well-known brands as

Armitron, Baume & Mercier, Bulova, Cartier, Casio, Citizen, Concord, Corum, Ebel, Hamilton, Helbros, Jaz, Jules Jurgensen, Lasalle, Longines, Lorus, Marcel, Movado, Omega, Piaget, Pulsar, Rado, Rolex, Ronda, Seiko, Swatch, Universal Geneve, Wittnauer and many others.

I. H.R. 2028

This legislation would benefit only those very few watch companies that produce watches in such foreign countries as the Philippines while doing significant harm to the remaining United States watch industry (in the mainland United States, the Virgin Islands and Guam). Specifically, H.R. 2028 would: (1) jeopardize a substantial portion of the United States employment provided by AWA member companies and dozens of other United States watch concerns; and (2) cause severe, and perhaps irremediable, damage to the watch assembly industry in the United States insular possessions.

A. Effect on United States Employment

The United States watch industry, although heavily dependent on watch imports, is highly internationalized. Companies typically produce watches from components (movements, dials, cases, bracelets and straps) made in more than one country. The heart of the remaining domestic watch industry consists of companies that assemble completed watches in the United States from several domestic and foreign manufacturers. These may be companies that prefer to use the United States as a hub for assembling products from several foreign locations, rather than shuttling the watch from country to country before bringing it to the United States. Alternatively, they may be companies taking advantage of United States statutory incentives to domestic assemblers. Specifically, such United States companies, many of whom are members of the AWA, include the following: (1) United States-owned assemblers of completed watches consisting of movements, cases, dials, bracelets and straps from one or more foreign countries; (2) United States affiliates of foreign parents that assemble their popularly priced watch lines in this country from components made in one or more overseas countries; and (3) companies, whether domestic or foreign owned, operating in the United States insular possessions (Virgin Islands and Guam) and Puerto Rico under one of several statutory programs to encourage light industry.

The AWA is aware of no major watch company that does not import the bulk of the watches sold under its brand name. However, AWA members engage in significant watch assembly work in the United States, Puerto Rico and the Virgin Islands, as well as case manufacture and other domestic watch production.

In fact, AWA companies provide the bulk of non-sales employment in the United States watch industry. Preliminary results of an ongoing survey show 5,150 domestic employees for 14 AWA member companies, the vast majority of whom are engaged in non-sales activities. (See Table 1.)

Table 1

U.S. Employment: Survey Results of 14 AWA Companies

	U.S.	U.S.V.I.	Puerto Rico	Total
Sales employees	576	--	--	576
Non-sales employees	4,299	210	65	4,574
Mgmt/clerical	1,718	9	10	1,737
Service/repair	476	18	4	498
Assembly/mfg.	1,394	180	51	1,625
Design research	134	--	--	134
Contract empls.	104	--	--	104
Warehouse/traffic	182	3	--	185
Other	291	--	--	291
Total U.S.employees	4,875	210	65	5,150

One company, with more than 1550 employees, reported more than 1400 non-sales personnel engaged in design, assembly and management activities. Another reported over 1350 non-sales workers, and a sales-distribution workforce (excluded from the 5,150 person total) of approximately the same size. The average workforce of the 14 companies was 368 employees; the median was 240. These figures ignore the hundreds of American companies that supply AWA member companies with watch cases, bracelets, parts, packaging materials, gold, gems and other materials. When the dozens of other domestic watch companies are considered, the total United States workforce approximates 10,000 people, according to many industry experts. This is the workforce subject to reduction as a result of H.R. 2028.

The AWA estimates that H.R. 2028 would give each watch produced in such countries as the Philippines a 36 to 72 cent duty saving and, correspondingly, a $1.10 to $2.20 retail price advantage against watches sold in the $20-$50 price bracket. Such a significant price advantage would affect sales of competing products by domestic assemblers to retailers and consumers, and would have to be met by these companies, which almost certainly would have to move their United States assembly operations entirely offshore, thereby dramatically reducing United States employment. In view of this, the AWA does not believe that H.R. 2028 conceivably could bolster domestic employment, as has been claimed by the only company in support of H.R. 2028 of which we are aware. To the contrary, the added lure of low-cost, duty-free production in the Philippines (along with the competitive disadvantage otherwise created by this legislation) would prove to be a strong magnet attracting away watch assembly work from the United States and its insular possessions.

B. Effect on the Insular Possessions

Congress and the Executive Branch have endorsed over many decades an extraordinary United States obligation to enhance the economies of the United States Virgin Islands, Guam and American Samoa. An important aspect of this commitment has been the so-called General Headnote 3(a) Program, enacted in 1954, which is designed to foster light industry in United States territories by providing duty-free tariff treatment to producers in the insular possessions.

In this regard, Congress and the President have recognized the crucial role of the watch assembly industry in the United States Virgin Islands, and established in 1983 a production incentive program to encourage the increased use of Virgin Islands and Guam labor for watch production in the islands. Production incentives, administered by the United States Commerce Department, are utilized to compensate employers for the use of relatively high-wage territorial labor. These incentives have helped the Virgin Islands watch industry pull itself out of a depression that saw employment fall from approximately 800 workers in the mid-1970's to below 100 in 1982. The workforce has rebounded somewhat - to approximately 450 workers -- as companies have begun to expand their operations under the new statutory program.

H.R. 2028 would abort this resurgence by compelling watch companies to move their operations to the low-wage GSP countries of the Far East in order to compete. Even if the Executive Branch did not actually list watches as eligible for GSP benefits, H.R. 2028 would remove the statutory proscription against eligibility. Thus, enactment of H.R. 2028 would create a great deal of uncertainty for watch companies, uncertainty that would restrain their interest in new or expanded investments in the United States territories at a critical time when those territories are counting on the watch industry to restore island employment to its historical peaks. It must be understood that the approximately 450 workers now in the Virgin Islands watch assembly industry represent one-fifth of the 2200 workers in all Virgin Islands manufacturing industries, and that the health of the watch assembly industry thus is vital to the overall health of the Vigin Islands economy.

H.R. 2028 would jeopardize that health and, by doing so, threaten United States obligations to its insular possessions.

II. H.R. 2029

The special marking requirements for watches that H.R. 2029 would eliminate were enacted at the turn of the century to inhibit fraudulent commercial practices, including the marking of erroneous countries of origin. Since that time, these requirements have served, and continue to serve, several important functions toward that end: (1) they assist trademark owners and law enforcement authorities in detecting counterfeits and identifying and prosecuting counterfeiters; and (2) they provide the Customs Service with a tool to assure compliance with import regulations. AWA member watch companies all observe the special marking requirements of Schedule 7 and believe that the costs of marking and compliance are minuscule compared to the benefits they provide in enhancing their intellectual property rights and protecting their reputation for a reliable product of quality in the eyes of the American consumer.

A. Effect on Anti-Counterfeiting Efforts

By deleting the special marking requirements for watches, H.R. 2029 would aggravate the difficulty that United States trademark owners and law enforcement agencies experience in detecting and prosecuting watch counterfeiters. Industry officials have informed us that in a number of instances, United States trademark owners, working closely with trademark owners abroad and law enforcement officials, have been able to use the internal markings on the movements, cases and dials contained in counterfeit watches imported into the United States to aid in tracking down and prosecuting the sources of these bogus watches. Without the information available from the movement, case and dial, this task would be much more difficult and, in some cases, impossible.

For example, examination of the required markings on the movement, case and dial enables trademark owners to determine initially the authenticity of each of these watch components. If the marking is found to be counterfeit, trademark owners oftentimes are able to determine the source of counterfeit manufacture by graphic analysis of the counterfeit marking and comparison of marking tools used by different companies in different locations. Such determinations have been useful when enforcement authorities initiate a seizure of counterfeits and in seeking to establish the nature of counterfeits in court.

If, on the other hand, the marking in question is found to be legitimate (as is the case where counterfeiters combine legitimate but inexpensive movements, case or dials with counterfeited styling or logos of more expensive brands), the legitimate special markings provide valuable information in tracing the chain of distribution, including identification of the counterfeiter by finding the company that has supplied the legitimate component to the counterfeiter overseas. The usefulness of the special markings on legitimate components in counterfeit products to trace the counterfeiting source is heightened by the difficulty that counterfeiters have had in attempting to modify or eradicate these markings. Unlike the country-of-origin marking on the back of the case or face of the dial required by Section 304 of the Tariff Act of 1930, the special markings required on various watch components have proven extremely difficult to modify.

Although the internal component markings are not visible to the potential customer of the watch, they are vital to law enforcement officials and United States trademark owners in detecting the foreign sources of the counterfeit watches that are being used to defraud the American public. Customs Service officials on the firing line in Chicago, Miami and New York have indicated they know the value of these markings. Indeed, in recognition of the importance of intellectual property rights and protection of the American consumer, Congress has strengthened the laws against counterfeiting and fraud; however, unless trademark owners and law enforcement officials retain the means to identify those who violate these laws, such prohibitions cannot be enforced.

B. Effect on Customs Service Enforcement

The Customs Service regards watch movements as the "guts" of the complete watch. Accordingly, the country-of-origin marking standard for compliance with Section 304 of the Tariff Act of 1930 is dependent on knowledge of the identity of the country in which the movement is produced (i.e., assembled). Moreover, the information with respect to jewel count -- another special marking requirement -- can be helpful in enforcing United States duty rates, which are distinguished on the basis of the number of friction-reducing jewel-pivots used in the movement.

Customs Service officials have expressed concern that watches that are assembled in one location from parts produced in other countries should conform to a uniform country-of-origin marking standard. In the example of a watch assembled in Hong Kong from a movement assembled in Taiwan, a dial made in Korea and a case made in Japan, the country-of-origin marking to satisfy section 304 would read "Taiwan" and would be engraved or stamped on the face of the dial or the outer back of the case. Without the special marking requirements of Schedule 7, however, the country of origin of the dial and case would be lost completely, and the country of origin of the movement itself could only be inferred by the Section 304 marking.

Furthermore, Customs officials have indicated that some watches may be entering the United States containing Russian movements but assembled in Hong Kong from cases and dials produced in non-Communist countries. Their concern is that these watches may not be marked properly and thereby permit the Russian movements to escape the higher tariffs for Column 2 countries. Thus, deletion of these special marking requirements could trigger import violations by permitting importation of watches with cases and dials made in Column 2 countries, permitting them to escape detection as Column 2 products.

III. Conclusion

H.R. 2028 would confer benefits on, at best, a discrete segment of the watch industry, the very few watch companies that do business in countries such as the Philippines. At the same time, it would cause substantial harm to the watch industry remaining in the United States, and abort the industry resurgence in our insular possessions. Similarly, H.R. 2029 would eliminate, at best, an inconvenience complained of by only one watch company of which we are aware. The price the United States would pay for this would be the wholesale elimination of a tool that has proven useful in curtailing the perpetration of a continuing fraud on the American public. Clearly, the detriments outweigh any conceivable benefits, and these special interest legislative proposals should be rejected.

BELAIR
WATCH CORPORATION

TELEPHONE (212) 679-2960
TELEX 421682

10 E 39 STREET NEW YORK N Y 10016 **MANUFACTURERS OF QUALITY TIMEPIECES FOR OVER THREE DECADES**

February 3, 1986

Mr. Joseph K. Dowley
Chief Counsel
Committee on House Ways and Means
U.S. House of Representatives
Room 1102 - LONGWORTH BUILDING
Washington D.C 20515

Dear Sir:

Re Bill H 2028 - to bring watches under GSP

Belair Quartz Inc , a Virgin Island Corporation established in 1962 and operating in the V.I. under the same ownership and management since, and Belair Watch Corporation, a New York Corporation operating under the same ownership and management since late 1945 both believe that passing the above bill would be most detrimental to the people employed , all of whom are American citizens.

The only beneficiary of this bill would be Timex, with assembly facilities in the Phillippines.

In 1982 Timex representatives testified before this committee that they employ 4000 people on the U.S. mainland. At this time, by their own admission they are talking about 1400 people. Surely no one can believe that the elimination of duty on Phillippine assembly would be an inducement to do more work in the U.S. The logical conclusion would be to do more work off shore where labor costs are much lower.The only protection against further reduction of the U.S. work force is the payment of the already modest duty on watches.

Therefore the elimination of this duty would not only deprive the U.S. Government of revenue on a foreign made product, but it would unfairly increase Timex market share at the expense of those companies who assemble their watches in the US Virgin Islands with American labor at American wages.

Timex has been refering to the retail price of the watches, which is not a proper criteria, because of the markup difference between watches being sold by Woolworth type chain stores and jewelers who back the products with their own service and guarantee of the product.

The only valid criteria is the wholesale price, and at that level the difference in favor of Timex would be increased by minimum 36¢ , which is presently the lowest duty rate on electronic modules.

BELAIR
WATCH CORPORATION

TELEPHONE (212) 679-2960
TELEX 421682

10 E. 39 STREET, NEW YORK, N.Y. 10016 **MANUFACTURERS OF QUALITY TIMEPIECES FOR OVER THREE DECADES**

The V.I. market share would be reduced by the elimination of this duty because the large users would certainly favor Timex for an additional saving of more than 36¢ in an industry where nickels and dimes make or break a deal.

In conclusion this bill should positively not be passed by the House Ways and Means Committee, whose job it is to protect American workers in our Possessions as well as on the mainland. We believe that the ability of the V.I. Industry to continue with the manufacture of watches is vital to the dignity and skill among the V.I. population and in the best national interest, as a bullwark of Democracy in the often turbulent Carribbean.

We thank you for your consideration and remain,

respectfully yours,

BELAIR WATCH CORPORATION

BELAIR QUARTZ INC

I. Grunwald, V.P/

STATEMENT OF BELMONT ELECTRONICS
IN SUPPORT OF HR2028 AND HR2029

BELMONT ELECTRONICS IS A SMALL ELECTRONICS DISTRIBUTOR IN CHICAGO, ILLINOIS. WE URGE THE COMMITTEE TO ADOPT HR2028 AND HR2029.

HR2028 WOULD MAKE WATCHES ELIGIBLE FOR DUTY FREE GSP TREATMENT AND ENABLE U.S. DISTRIBUTORS SUCH AS BELMONT ELECTRONICS TO OFFER GREATER VALUE AT LOWER PRICES TO ITS CUSTOMERS. WE BELIEVE HR2028 WOULD NOT ONLY BENEFIT BELMONT ELECTRONICS, BUT WORKING FAMILIES IN CHICAGO WHO WILL BE ABLE TO BUY TIMEX WATCHES OR LOW COST WATCHES FROM LESSER DEVELOPED COUNTRIES AT AN AFFORDABLE PRICE.

HR2029 WOULD ELIMINATE UNNECESSARY MARKINGS ON THE INSIDE OF A WATCH AND THE COST OF SUCH MARKINGS WHICH ARE PASSED ON TO OUR CUSTOMERS.

WE URGE THE SUBCOMMITTEE TO SUPPORT THIS LEGISLATION FOR THESE REASONS.

STATEMENT OF HON. BEN BLAZ, A DELEGATE TO CONGRESS FROM GUAM

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM OPPOSED TO H.R. 2028 WHICH WOULD GRANT GSP TREATMENT TO WATCHES. THIS WOULD DESTROY THE GUAM WATCH INDUSTRY BY ALLOWING GSP ENTRY OF WATCHES FROM LESSER DEVELOPING COUNTRIES (LDC'S). GSP TREATMENT FOR THE LDC'S WILL UNDERMINE CURRENT INCENTIVES AS CONTAINED IN P.L. 97-442 FOR THE PRODUCTION OF WATCHES IN THE U.S. INSULAR POSSESSIONS. THESE INCENTIVES WERE ENACTED BY CONGRESS TO ENCOURAGE AN INDUSTRY IN THE TERRITORIES WHICH WOULD OTHERWISE LOCATE ONLY IN THE FAR EAST. THE INCENTIVES OVERCOME THE ADDED EXPENSE OF DOING BUSINESS IN AN AMERICAN TERRITORY SUBJECT TO AMERICAN LAWS AND REGULATIONS. WITHOUT THESE INCENTIVES GUAM'S EXISTING WATCH INDUSTRY WILL CEASE, AND THE INDUSTRY WILL RELOCATE TO THE FAR EAST. BOTH THE TERRITORY AND THE UNITED STATES WILL LOSE.

GUAM NEEDS A STRONG PRIVATE INDUSTRY IN THIS ERA OF DECREASED FEDERAL SPENDING. THE WATCH INDUSTRY IS PART OF GUAM'S EFFORT TO PAY FOR ITSELF AND NEEDS THE SECURITY OF KNOWING THAT ITS COMPETITIVE EDGE IS WRITTEN IN THE ROCK OF LAW. H.R. 2028 WILL UNDERMINE THIS SECURITY BECAUSE GSP TREATMENT FOR WATCHES CAN BE EXTENDED TO THE LDC'S BY THE STROKE OF AN ADMINISTRATOR'S PEN. ON BEHALF OF THE TERRITORY OF GUAM I, THEREFORE, OPPOSE IT.

STATEMENT OF
THE HONORABLE DALE BUMPERS AND
THE HONORABLE DAVID PRYOR
IN SUPPORT OF H.R.2028 AND H.R.2029
WAYS AND MEANS TRADE SUBCOMMITTEE
FEBRUARY 6, 1986

As sponsors of the companion bills in the Senate, we urge the subcommittee to adopt H.R. 2028 and H.R. 2029.

H.R. 2029 would eliminate certain markings on the inside of a watch, thereby alleviating unnecessary administrative burdens for the U.S. Customs Service, which already finds its resources and manpower stretched to the limit. The bill would also eliminate unnecessary costs which are ultimately passed on to the consumer.

H.R. 2028 would make watches eligible for duty-free GSP treatment. The bill would enable Timex Corporation, which has maintained significant watch operations in Arkansas for over 40 years, to compete more effectively with Japanese and other foreign competitors. The massive importation of low cost watches from Japan, Hong Kong and other foreign manufacturers has caused the loss of 3,300 Timex jobs in Arkansas alone, and today fewer than 600 are left there. While all U.S. watch companies since 1974 have found it necessary to move operations off-shore, Timex Corporation alone continues to perform many watchmaking operations in the U.S. Skilled watchworkers in Arkansas continue to diecast, manufacture casebacks and crystals, and perform various plating, repair, service and customer service functions.

Unlike many industries which have witnessed the flight of U.S. technology and U.S. jobs overseas and which come before the Congress seeking protection in order to survive, Timex is not seeking protectionist legislation. On the contrary, H.R.2028 would eliminate duties on watches, under the supervision of agencies of the federal government with expertise in international trade. We believe that this action would enable Timex to retain its operations in Arkansas and keep watch technology in the U.S.

H.R.2028 would benefit not only workers in the state of Arkansas but all consumers who will be able to continue to buy a reliable American watch at a price they can afford.

We urge your support for legislation that would promote free trade, benefit U.S. workers and consumers and keep technology in the U.S. We believe that early passage of H.R.2028 and H.R. 2029 will accomplish these goals.

COMMENTS ON H.R. 2029 OF THE FEDERATION OF THE SWISS WATCH INDUSTRY BEFORE THE SUBCOMMITTEE ON TRADE OF THE COMMITTEE ON WAYS AND MEANS OF THE UNITED STATES HOUSE OF REPRESENTATIVES

The Federation of the Swiss Watch Industry urges the Subcommittee on Trade to reject H.R. 2029, a bill which would delete the special marking requirements for imported watches under Headnote 4, Schedule 7, Part 2, Subpart E of the Tariff Schedules of the United States.

The Federation of the Swiss Watch Industry, headquartered in Bienne, Switzerland, is composed of watch companies and trade associations which in the aggregate represent virtually all Swiss producers of watches, watch movements and watch parts. It has not been the practice of the Federation to participate in the U.S. legislative process. However, because of the importance of this legislation, the Federation has felt it necessary to submit these comments.

H.R. 2029 would repeal the special marking requirements applicable to watches and clocks in the Tariff Schedules of the United States. Under current law, watch movements and watch cases must be marked with the country of origin and the name of manufacturer or purchaser of the case or movement, and watch dials must be marked with country of origin of the dial. These requirements also apply to finished watches.[1]

The elimination of the marking requirements proposed by H.R. 2029 would seriously impede current U.S. Government and watch industry efforts to prosecute watch counterfeiters and would deprive the Customs Service of a useful tool in assuring compliance with foreign origin disclosure requirements. In addition, the marking requirements have become the basis for the after-sales service. Without them, consumers will experience greater difficulty in having watches repaired in a timely fashion.

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[1] The Tariff Schedules also require the disclosure of the number of jewels and adjustments. These elements are of less importance in modern watch manufacturing, and their disclosure does not contribute to the anticounterfeiting or repair effort. Therefore, the Federation would have no objection to their deletion from the Tariff Schedules of the United States.

With the exception of the Timex Corporation, the author and primary sponsor of this legislation, watch companies support the continuation of the marking requirements. These companies believe that the minimal costs to comply with the requirements are insignificant[2] in relation to the benefits they provide in protecting intellectual property rights, the reputations of the companies who manufacture watch products and the consumers who purchase them. Timex, on the other hand, apparently considers it more important to withhold from the watch trade the origin of its Philipine product.

* * * * * *

Over the past two decades, the Federation has played an increasingly active role in detecting and combatting the counterfeiting of watches worldwide. Watches are particularly vulnerable to counterfeiting due to the significance the public places on watch brand names and the ease with which inferior watch parts and movements may be hidden from the consumer within the watch. As a result, the Federation maintains and operates its own anticounterfeiting monitoring and investigative service in order to protect the watch-purchasing public.

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[2] From 1.5 to 2.5 cents per movement. See page 5, infra.

The elimination of special marking requirements would intensify the difficulty that watch producers and law enforcement agencies currently experience in detecting and prosecuting watch counterfeiters. The country of origin and manufacturer marking requirements are of critical importance in identifying counterfeit watches. They permit experienced investigators to know exactly where watches are being manufactured, the origin of the parts, and frequently the place of assembly. The markings demonstrate whether the watches are original or counterfeit. This determination becomes of importance when the U.S. Customs Service seeks to seize imported counterfeit watches, or when the trademark owner seeks to exercise his rights in court under the Trademark Counterfeiting Act of 1984.

Perhaps of even more importance, these markings allow experienced personnel employed by the Federation to trace the source of watch counterfeiting on a worldwide basis. For example, the identification of a counterfeit source in Hong Kong would enable the Federation, through its offices there, to have Hong Kong authorities seize the counterfeit merchandise before it departs for the United States. The markings further enable Federation and Hong Kong investigators to identify entities who supply parts to the counterfeiters. Morever, if a marking is itself counterfeit, an analysis of the mark permits investigators to trace watches which are purchased in several locations or countries to the same marking tool.

Timex, however, would have the Subcommittee believe that marking requirements serve no purpose to the consumer because they are inside the watch case. However, generally speaking, the origin of the watch is the origin of the movement under both the Tariff Act of 1930 and the Federal Trade Commission Guides for the Watch Industry. Without the special marking requirements, both the FTC and the Customs Service would be hindered in enforcing the foreign origin disclosure requirements for the watch itself.[3]

During hearings on H.R. 2029 before the Subcommittee on February 6, 1986, Ronald Marsching of the Timex Corporation testified that the marking requirements imposed a "needless burden" on watch producers and consumers because consumers ultimately bore the cost of compliance with the requirements.

The Federation points out that watch companies have observed the marking requirements since 1909. A canvassing of Federation manufacturing members discloses that the actual costs of marking a movement during the course of manufacture range from 1.5 cents to 2.5 cents per movement. There is no additional cost in marking the face of the dial at the time the dial is "dressed." With respect to cases, independent inside marking ranges in cost from 7.5 cents to 12.5 cents. Outside markings cost even less. Such de minimis costs are slight when compared to the benefits the markings provide.

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[3] Customs officials have also expressed concern that watches may be entering the United States which contain Russian movements but which are assembled in Hong Kong from cases and dials produced in non-Communist countries. Russian movements which are not marked properly may be escaping the higher Column 2 duty rates for Communist countries.

Timex also takes the position that three U.S. statutes which would be unaffected by the repeal of the marking requirements are sufficient to protect the watch-consuming public from counterfeiters. The Federation submits that all three statutes cited - - Section 304 of the Tariff Act of 1930, Section 5 of the Federal Trade Commission Act, and Section 43 of the Lanham Act - - either do not confer upon consumers a direct cause of action against counterfeiters, or would be difficult if not impossible to enforce if the special marking requirements were repealed. Section 5 of the Federal Trade Commission Act (15 U.S.C. §45) gives only the Commission and not the consumer the right to bring actions to enjoin unfair methods of competition. Similarly, Section 304 of the Tariff Act of 1930 (19 U.S.C. §1304) gives only the Customs Service a right of action against persons who violate the requirement that country-of-origin markings appear on all imported goods. Finally, Section 43 of the Lanham Act (15 U.S.C. §1125) provides only that injured citizens may bring a civil action against persons who affix false designations of origin upon imported goods. Clearly, the relatively insignificant impact these statutes already have upon the prosecution of counterfeiters would be even weaker without the special marking requirements for tracing counterfeit goods.

The Timex testimony noted that since the decision of United States v. Texas Instruments, Inc., 673 F.2d 1375 (Cust. App. 1982), the marking requirements have not applied to digital watches and clocks, which comprise approximately 70% of watch and clock imports into the United States. Timex further states that this development has created "no apparent problem" for producers or regulators. The Federation responds that the overwhelming majority of counterfeit watches consistently have been nondigital, analog watches which, because of their better recognized brand name, and higher quality and price, are more attractive to counterfeiters to fabricate. The continuation of the marking requirements are essential.

The origination markings are also very important in after-sales service to the watch purchaser because they allow watchmakers and wholesale distributors of spare parts to trace the origin of a movement and identify the manufacturer for replacement purposes. The Swiss watch industry has spent much time and effort to develop an efficient after-sales service system based upon the markings on the movement, case and dial.

The Japanese also use such a system. These systems have been proven to be very valuable to the trade and ultimately to watch consumers by providing better repairs and quicker after-sales service.

Therefore, because of the unquestionable usefulness of the special marking requirements in detecting and deterring counterfeit watch traffic and facilitating after-sales service, the Federation urges the Subcommittee to reject H.R. 2029.

Lamb & Lerch
Counsellors at Law

233 Broadway
New York, N.Y. 10279

Cable: Lamlerch N.Y.
(212) 608-2700

February 10, 1986

Joseph K. Dowley, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Room 1102
Longworth House Office Building
Washington, D.C. 20515

Re: **H.R. 2029**

Dear Sir:

By Press Release #15 dated January 24, 1986, the Subcommittee on Trade, Committee on Ways and Means, announced that it was providing an opportunity for the submission of views with respect to the above referenced Bill. We are hereby filing the following comments as counsel to General Time Corporation,[1] 520 Gutheridge Court, Technology Park/Atlanta, Norcross, Georgia 30092.

General Time Corporation is a major domestic producer,[2] as well as an importer of various time keeping apparatus including alarm clocks, (keywound, quartz battery operated, digital and electric), travel clocks, wall clocks, pocket watches, timers and clock radios. H.R. 2029 proposes to eliminate the Special Marking Requirements for clocks and watches, which are presently provided by Headnote 4 of Schedule 7, Part 2, Subpart E of the Tariff Schedules of the United States. General Time Corporation

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1. General Time Corporation consists of two divisions — Westclox and Seth Thomas.

2. General Time Corporation's principal manufacturing facility is located at Newton Bridge Road, Athens, Georgia 30607

opposes the elimination of these Special Marking Requirements for imported watches, clocks and components thereof.

The Special Marking Requirements for clocks and watches, presently provided by Headnote 4 of Schedule 7, Part 2, Subpart E, TSUS, were initially enacted approximately 80 years ago by the Tariff Act of August 5, 1909. Pub. L. No. 5. §1, Schedule C, Para. 192 (61st Cong.) This Act was designed to provide revenue, equalize duties, **encourage the United States industries**, and for other purposes. H.R. 1438, 61st Cong. 1st sess. (1909).

Prior to the 1909 Tariff Act there were only general marking requirements for all articles of foreign merchandise:

> [A]ll articles of foreign merchandise, such as are usually or ordinarily marked, stamped, branded, or labeled, and all packages containing such or other imported articles, shall, respectively, be plainly marked, stamped, branded, or labeled in legible English words, so as to indicate the country of their origin and the quantity of their contents . . . . (emphasis added)

The Tariff Act of August 27, 1894, Chap. 349, §5.

There was no requirement regarding the marking of the name of the manufacturer. The 1909 Act introduced the following provisions in pertinent parts:

> [A]ll watch and clock dials, whether attached to movements or not, shall have indelibly painted or printed thereon the country of origin, and that all watch movements, lever clock movements with jewels in the escapement, and cases of foreign manufacture shall have the name of the manufacturer and country of manufacture cut, engraved, or die-sunk conspicuously and indelibly on the plate of the movement and the inside of the case, respectively, and the movements shall also have marked thereon by one of the methods indicated the number of jewels and adjustments, said number to be expressed both in words and in Arabic numerals . . . .(emphasis added)

Testimony and statements made by several domestic manufacturers during the Ways and Means Committee Hearings reveal the background and reasons for providing such Special Marking Requirements. The domestic manufacturers were concerned about the foreign manufacturers' practice of imitating their high-quality watches and clocks and selling them in the United States at much lower prices. The following testimony made by Walter Camp, a private manufacturer, conveyed such concern of the domestic manufacturers:

> [S]everal foreign countries sent secretly their best men over here . . ., surreptitiously acquir[ed] the knowledge of Amercian manufacturers . . . . They imitated the shape and conformation of our best-known clocks, and finally took the actual American names and labels, and by means of these methods of piracy turned many markets against us, both directly by offering the goods with these descriptions and indirectly by giving poorer quality under the names, thus lessening the esteem in which these names had been known.

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Supplemental Brief Filed By Walter Camp, of the New Haven (Conn.) Clock Company, Committee on Ways and Means (Dec. 1, 1908), 3 *Tariff Hearings* (1908-1909) 2540 (1909).

There was other testimony concerning Swiss imitation railroad watches. Apparently, Swiss manufacturers used fictitious names and intitals to simulate the names of well-known American manufacturers of railroad watches which were generally understood by American consumers to be of a very high grade. *Hamilton Watch Co., Lancaster, PA., Submits Brief Regarding Swiss Imitation Railroad Watches* (Dec. 31, 1908), *id.* at 2528. The domestic manufacturers also testified that foreign-manufactured enameled dials used a rubber stamp to mark the country of origin so easily rubbed off after importation. *The O'Hara Waltham Dial Co., Waltham, Mass., Asks for New Classification for Watch Dials* (Nov. 23, 1908), *id.* at 2534.

Thus, the Special Marking Requirements were enacted to afford protection to the domestic industry from improperly marked foreign timepieces and have provided such protection for nearly 80 years. Two of the factors Congress has traditionally considered with regard to the passage of proposed legislation which would impact upon a domestic industry is (A) the effect of the proposed legislation on domestic producers, and (B) the effect of the proposed legislation on the ultimate consumer. Since the Special

Marking Requirements of Headnote 4 were enacted to protect both domestic manufacturers and the ultimate consumer from fraudulent marking, General Time Corporation is in favor of continuing said requirements on all imported clocks, watches, movements, cases and dials. General Time Corporation therefore urges the Committee on Ways and Means to recommend against passage of the legislation as proposed.

Respectfully submitted,

Lamb & Lerch
233 Broadway
New York, N.Y. 10279
Tel.: 212-608-2700

By: David R. Ostheimer

DRO:do

Jewelers of America, Inc.

February 12, 1986

Mr. Joseph K. Dowley
Chief Counsel
House Ways and Means Committee
1102 Longworth Building
Washington, D.C. 20515

Reference: H.R. 2029

Dear Mr. Dowley:

This statement in opposition to H.R. 2029 is being filed on behalf of the Jewelers of America, Inc. ("JA") a national trade association comprised of over 12,000 retail jewelry businesses. It is requested that it be placed in the printed record of the hearing in which H.R. 2029 was discussed.

For nearly 75 years, Congress has required special marking requirements for watches. H.R. 2029 would remove these requirements which are contained in Headnote 4, Schedule 7, Part 2, Subpart E of the Tariff Schedules of the United States.

JA urges the members of the House Ways and Means Committee to reject H.R. 2029 for the following reasons:

1. Special marking requirements on watch movements, cases and dials have helped to deter fraudulent imports, and, at the same time, given the U.S. Customs officials an effective way to verify if the external marking requirements of Section 304 of the Tariff Act of 1930 are being complied with.

2. At a time when the importation and sale of counterfeit watches have reached epidemic proportions, the enactment of H.R. 2029 would be antithetical to the jewelry industry's and law enforcement officials' efforts to track foreign sources of counterfeit watches. The special watch marking requirements have allowed investigators in some instances to find the sources of the fake watches. On the one hand, Congress in the Trademark Counterfeiting Act of 1984 encouraged our industry to enforce valuable trademarks and protect the reputation of trade names, and now if enacted, H.R. 2029 would vitiate any progress that we have been able to make in the last few years.

[illegible] • Rockefeller Center • [illegible] Avenue of the Americas • [illegible] • 212 [illegible]
[illegible]

3. We note with dismay the Administration's proposed budgetary cutbacks for Customs enforcement officials. That, in itself, is a sad development, but to have Congress take away a tool that enterprising Customs officials have used to seek out marking violations and counterfeits involving the watch trade is like throwing salt on a wound.

4. Over the three quarters of a century that these marking requirements have been in effect the legitimate watch manufacturers have supported and complied with these special marking requirements. The cost of compliance is really a pittance compared with the benefits conferred by protecting trade names and commercial reputations.

JA respectfully urges the Committee to reject H.R. 2029, and thereby continue marking requirements that continue to serve their purpose. Indeed, they may be needed more than ever.

Sincerely yours,

Michael D. Roman
Chairman

SIL/psk

K MART CORPORATION
INTERNATIONAL HEADQUARTERS
3100 WEST BIG BEAVER RD
TROY, MICHIGAN 48084

A. ROBERT STEVENSON
VICE PRESIDENT
GOVERNMENT & PUBLIC
RELATIONS

February 3, 1985

The Honorable Sam Gibbons
Chairman of the House
Trade Subcommittee
U. S. House of Representatives
Washington, DC 20515

Re: GSP - Watches -- H.R. 2028

Dear Mr. Gibbons:

This is to indicate our support for the GSP amendment bill which would make import watches eligible for GSP duty-free treatment.

The bill is supported by Timex Corporation, the only remaining domestic industry member making watches in the United States. The fact is that Timex can better compete from withering import competition from GSP countries such as Japan, Switzerland, Hong Kong if GSP eligibility is extended to imported watches.

The inclusion of low-priced watches in the GSP eligibility program would enable companies like Timex and other importers to import watches from, conceivably, the Philippines and other lesser developed nations, and benefit the consumers' pocketbook here in the United States, and increase employment of the watch assembly and distribution businesses here in the United States. That would increase overall employment in the watch making and watch assembly-distribution businesses here in the United States.

This is a bill which is good for consumers, good for United States businesses of all types, and good for particularly interests of lesser developed nations vis-a-vis the relatively highly developed nations which presently have a globalistic share of the imported watch market (Japan, Switzerland, Hong Kong, for example).

We need your support of this bill.

Sincerely,

A. ROBERT STEVENSON

Statement on behalf of
Manufacturing Jewelers and Silversmiths of America, Inc.
In Opposition to H.R. 2028 and H.R. 2029

Before the Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives

February 13, 1986

H.R. 2028 and H.R. 2029:

The Manufacturing Jewelers and Silversmiths of America (MJSA) is in opposition to both H.R. 2028 and H.R. 2029. H.R. 2028 would remove watches from the list of products that are proscribed from eligibility for duty-free tariff treatment under the Generalized System of Preferences (GSP). H.R. 2029 would delete the special marketing requirements for watches in Headnote 4, Schedule 7, Part 2, Subpart E of the Tariff Schedules of the United States.

Submitted By:

Lewe B. Martin, Counsel for MJSA; Thompson, Hine and Flory, 1920 N Street, N.W., Washington, D.C. 20036, (202) 331-8800.

MJSA Membership:

MJSA is comprised of approximately 2,500 members including manufacturers of finished products, suppliers to the jewelry industry, salesmen, manufacturers' representatives, artisans and craftsmen.

Summary of H.R. 2028:

- It will adversely affect U.S. employment in the watch industry.
- It will have a devastating effect on the watch assembly industries of United States insular possessions.

U.S. Employment:

The U.S. watch industry consists of enterprises which produce watches from imported components or which assemble completed watches from domestic and foreign manufacturers. The assembling companies fall into three categories including U.S.-owned assemblers, U.S. affiliates of foreign companies, and both foreign and domestic companies having operations in U.S. insular possessions. The United States work force stands at approximately 10,000.

H.R. 2028 would grant significant savings on duty rates to a handful of countries at the expense of the watch industry in the United States and its insular possessions. The savings will result in a sizable price advantage to other countries, requiring a response from the U.S. watch industry. That response will be to move offshore seeking low labor costs in the very countries which will be benefiting from duty-free treatment under H.R. 2028. Such a move will be enough to seriously undermine the U.S. watch work force and could irreparably damage the industry in U.S. insular possessions.

Economy of U.S. Insular Possessions:

The General Headnote(3)(a) Program was instigated for the purpose of encouraging light industry in U.S. insular possessions by granting duty-free treatment to producers. In 1983, Congress established a production incentive program to promote use of labor in the Virgin Islands and Guam specifically for watch production. The production incentives counteracted the relatively high wage rates on the islands. H.R. 2028 would undo the incentive program, forcing employers to seek lower wages in the Far East in order to remain competitive. Although it can be argued that the bill only lifts the restriction against watches being placed on the GSP list, employers would still be encouraged to begin moving their enterprises from U.S insular possessions to the Far East in anticipation of foreign countries' efforts to see watches established on the GSP list.

In the Virgin Islands, there are 450 workers in the watch industry, representing one-fifth of all workers in that economy's manufacturing sector. If the watch industry is forced to pull out, the entire economy will suffer.

Summary of H.R. 2029:

- It is unfair to consumers as it overturns the long established practice of notifying consumers and protecting them from fraud.

- It will take away the benefit which special markings give trademark owners and law enforcement authorities since the markings help them find counterfeit products and counterfeiters.
- It will hinder the Customs Service in the Service's effort to ensure that import regulations are complied with.
- The costs and minimal inconvenience of markings are very low compared to the benefits the markings provide by protecting intellectual property rights and consumers.

Unfair to Consumers and against Congressional Intent:

A country-of-origin marking tells the consumer where the watch was assembled, information which may well determine whether he will make a purchase. Other special markings, while not visible to the consumer, protect the consumer by ensuring that he does not receive counterfeit clocks and watches for his money. It is the intent of Congress to prevent consumers from being defrauded through Congress' strengthening of laws prohibiting counterfeiting and fraud. However, H.R. 2029 will paralyze law enforcement officials in their effort to enforce congressional intent.

Identifying Counterfeits will be much more difficult:

The markings on clocks and watches have enabled trademark owners and law enforcement personnel to identify products as counterfeit and even to identify a specific counterfeiter. The special markings reveal whether a watch component is authentic. If it is found to be counterfeit, an examination of the markings can reveal the types of tools used which can lead authorities to the offending company. If a marking is authentic but legitimate parts are combined with counterfeit parts, the markings can identify which supplier provided the counterfeiter with the legitimate parts. These special markings are particularly difficult to alter, unlike the more easily altered country-of-origin markings.

Customs Service will be at distinct disadvantage:

The country-of-origin marking under section 304 of the Tariff Act of 1930 is not the only special marking and cannot perform the task necessary to identify the origin of all watch parts. It reveals only the country of assembly. That means that all the component parts of the watch could come from any other country. Without the other special marking requirements in Schedule 7, Customs officials would never know the country-of-origin of each part of the watch. Unless the marking requirements are retained, countries which are subject to higher tariff rates, like the Soviet Union, could evade those tariffs by ensuring that assembly takes place in another country.

In addition, another special marking requiring jewel count information enables Customs officials to apply the correct duty rate according to the number of jewels. Elimination of this requirement could inhibit collection of duties. Customs officials endorse special markings.

Minimal Cost versus Maximum Loss:

MJSA is aware of only one company which has complained about the special marking requirements. The markings maintain and perpetuate the integrity of the entire industry, ensuring consumers and members of the industry of authenticity.

Conclusion:

The disastrous economic effect of H.R. 2028 does not justify the advantage given to a small number of foreign countries. Specifically, the damage to U.S. insular possessions threatens U.S. obligations to those possessions. H.R. 2029 eliminates an entire system of determining counterfeiting and fraud for the sole purpose of eliminating the mere inconvenience of special markings.

STATEMENT OF THE MARSHALL-SWARTCHILD COMPANY IN SUPPORT OF HR2028 AND HR2029

MARSHALL-SWARTCHILD COMPANY HAS BEEN A DISTRIBUTOR OF WATCHES AND JEWELRY IN CHICAGO, ILLINOIS FOR MANY YEARS EMPLOYING NEARLY 40 PEOPLE IN ITS BUSINESS. WE URGE THE COMMITTEE TO ADOPT HR2028 AND HR2029.

HR2029 WOULD ELIMINATE UNNECESSARY MARKINGS ON THE INSIDE OF A WATCH, AND THEREFORE UNNECESSARY COSTS WHICH ARE ULTIMATELY PASSED ON TO THE CONSUMER.

HR2028 WOULD MAKE WATCHES ELIGIBLE FOR DUTY FREE GSP TREATMENT WHICH WOULD ASSIST IN COMBATING THE ADVANTAGES ENJOYED BY JAPANESE AND OTHER FOREIGN PRODUCERS WHO WOULD NOT BE AFFECTED BY THE BILL.

UNLIKE MANY COMPANIES WHO HAVE EXPORTED U.S. TECHNOLOGIES AND JOBS OVERSEAS, TIMEX CORPORATION CONTINUES TO PERFORM MANY WATCH MAKING OPERATIONS IN THE U.S., AND IS COMMITTED TO AMERICAN INDUSTRY AND DISTRIBUTORS LIKE OURSELVES. WE WOULD LIKE TO POINT OUT HR2028 IS NOT A PROTECTIONIST BILL, BUT ONE WHICH WOULD QUALIFY WATCHES TO BE CONSIDERED FOR DUTY FREE GSP TREATMENT BY AGENCIES IN THE ADMINISTRATION WITH EXPERTISE IN INTERNATIONAL TRADE. WE BELIEVE HR2028 WOULD BENEFIT NOT ONLY OUR COMPANY, BUT WORKING FAMILIES WHO WILL BE ABLE TO CONTINUE TO BUY A RELIABLE AMERICAN WATCH AT AN AFFORDABLE PRICE. WE URGE YOUR SUPPORT FOR A BILL THAT WOULD HELP U.S. CONSUMERS AND KEEP TECHNOLOGY IN THE U.S.

FOR THESE REASONS, OUR COMPANY URGES MEMBERS OF THE SUBCOMMITTEE TO SUPPORT HR2028 AND HR2029.

RONDA WATCH CORP. OF AMERICA
Swiss analog quartz and mechanical watch movements

PAUL R. SUTTER
General Manager

February 12, 1986

Joseph K. Dowley, Esq.
Chief Counsel
Committee of Ways and Means
U.S. House of Representatives
Room 1102
Longworth House Office Building
Washington, D.C. 20515

RE: H.R. 2028 AND H.R. 2029

Dear Sir:

This letter is sent to you on behalf of Progress Watch Co., Inc., St. Croix, US Virgin Islands, for which I am the acting secretary.

Progress Watch Co. is the largest US Virgin Islands watch assemler, providing employment for a substantial number of people in this economically disadvantaged area.
Since 1973 Progress Watch Co. has taught , without outside financial assistance, hundreds of US Virgin Islands residents the skills of watchmaking and assembly of watches and electronic watch movements.

We oppose enactment of bill H.R. 2028.

This bill is designed to be a major thread to the survival of the US Insular Possessions duty-free watch assembly industry, diminishing the incentive and competitive advantage producers in the US Virgin Islands presently enjoy.
The viability of this industry depends on a maintenance of the differential between US Virgin Islands benefits and duties on direct imports.
The proposed bill H.R. 2028 would reduce dramatically the differential and very likely could destroy the US Virgin Islands watch industry.

We also oppose the enactment of bill H.R. 2029.

Bill H.R. 2029 would eliminate the special marking requirements for watch movements and watch cases.
Progress Watch Co. as major assembler of watch movements and watches is committed to preserving the integrety of watch movements and

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390 Fifth Avenue, New York, N.Y. 10018 • 212/564/2567 • Telex 238508 Ronda UR 'Home Office: Ronda SA•CH-4415 Lausen / Switzerland

watches it produces for the US market.

United States marking requirements have worked for many decades to protect legitimate watch producers, such as ourselves against fraudulent practices such as counterfeiting and false valuation of watch products.

We respectfully urge the trade subcommittee to reject both H.R. 2028 and H.R. 2029.

Respectfully submitted,

Paul R. Sutter

Paul R. Sutter
Secretary of Progress Watch Co., Inc.

PRS/rs

cc: Mr. G. Ruhle, Vice-President, Progress Watch Co, Inc. US VI

SERVICE EMPLOYEES
INTERNATIONAL UNION, AFL-CIO, CLC
1313 L STREET N.W. • WASHINGTON, D.C. 20005 • (202) 898-3200

JOHN J. SWEENEY
INTERNATIONAL PRESIDENT

RICHARD W. CORDTZ
INTERNATIONAL SECRETARY-TREASURER

March 7, 1986

Mr. Joseph K. Dowley
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: H.R.2028 - Eliminating Duty on Watches from Philippines

Dear Mr. Dowley:

Service Employees International Union (SEIU), AFL-CIO, represents over 850,000 workers. Our members include hundreds of watchmaking industry employees including employees of Timex who will be directly affected by H.R. 2028. SEIU believes the legislation which would eliminate duty on watches, clocks and parts reflects an ill-advised trade policy facilitating cheaper imports and the movement of American jobs overseas.

At a time when millions of Americans are out of work and the American market is flooded with imports which displace domestic production and American jobs, this bill simply does not make sense. Freeing up restrictions on imports will only further the erosion of the U.S. industrial base. In addition, it cuts back on needed revenues at the same time Congress is struggling to meet its goals of reducing a burdensome deficit.

Timex claims H.R.2028 will protect American jobs. Since Timex opened its plant in the Philippines, however, the number of workers it employs in the United States has dropped from 4000 to 1400. Allowing Timex to import watches duty free from the Philippines only increases the impetus to expand its overseas operations. The legislation will not create jobs within the United States and is likely to increase the influx of cheap imports.

In addition while Timex may benefit from increased imports of duty free watches from the Philippines the legislation would enable other GSP eligible countries to manufacture and import watches duty free to the United States. These duty free imports would compete directly with watches made and assembled by union workers in the United States Virgin Islands and SEIU members in the United States.

SEIU believes H.R.2028 conflicts with our longstanding policy favoring a coordinated, comprehensive trade and reindustrialization strategy promoting the revitalization of our industrial base. Allowing importation of duty free watches serves only to encourage the expansion of overseas operations at a time when we need to focus on rebuilding the American industrial base.

Sincerely,

John J. Sweeney
International President

STATEMENT IN SUPPORT OF H.R. 2028

SUBMITTED FOR WALGREEN CO.
BY EDWARD H. KING
DIRECTOR OF GOVERNMENTAL
AND PUBLIC AFFAIRS
200 WILMOT ROAD
DEERFIELD, ILLINOIS 60015
312/940-3550

WALGREENS OPERATES 1,165 DRUG STORES IN 28 STATES AND PUERTO RICO, AND FOR MOST OF WALGREENS' 85-YEAR HISTORY WATCHES AND CLOCKS HAVE BEEN AN INTEGRAL PART OF THE PRODUCT MIX. CUSTOMERS HAVE COME TO EXPECT A SELECTION OF QUALITY TIMEPIECES AT VERY COMPETITIVE PRICES.

PRESENTLY WALGREENS SELLS APPROXIMATELY 400,000 TIMEX WATCHES AND CLOCKS ANNUALLY, AND IT IS ANTICIPATED THAT THE DEMAND FOR THIS LINE OF TIMEPIECES WILL CONTINUE AND EXPAND.

PREVIOUSLY WATCHES WERE EXCLUDED FROM GSP TREATMENT BECAUSE OF THE NEED TO PROTECT DOMESTIC WATCH ASSEMBLY. BECAUSE THERE IS NO LONGER A NEED FOR THIS PROTECTION, H.R. 2028 REMOVES THIS EXCLUSION.

CURRENTLY THERE IS STILL A DOMESTIC INDUSTRY INVOLVED IN WATCH DESIGN, ENGINEERING, RESEARCH, DEVELOPMENT, MANAGEMENT, AND SERVICE. FURTHER, THERE ARE NUMEROUS DOMESTIC JOBS IN WATCH PRODUCTION INCLUDING WATCH PARTS, CASE MAKING, AND CASE PLATING. WITHOUT THIS LEGISLATION, U.S. FIRMS WILL NOT BE ABLE TO COMPETE EFFECTIVELY WITH FAR EASTERN COMPETITORS. THIS FINAL SEGMENT OF THE DOMESTIC WATCH INDUSTRY WILL DECLINE, AND JOBS IN FINAL PRODUCTION OF WATCHES WILL DISAPPEAR.

THE DISAPPEARANCE OF TIMEX WOULD REMOVE OUR CUSTOMERS' OPTION TO PURCHASE FROM A LINE OF WATCHES WHICH THEY HAVE GROWN TO RESPECT. THEREFORE, WALGREENS ENCOURAGES THE COMMITTEE TO REPORT THIS CHANGE.

RTK 1/28/86

H.R. 2225

Relating to the customs treatment of certain wearing apparel produced in the insular possessions of the United States.

STATEMENT OF
AMERICAN INTERNATIONAL KNITTERS
YURI FASHIONS CO., LTD.

This statement is submitted on behalf of American International Knitters Corp. of Saipan in the Commonwealth of the Northern Mariana Islands (CNMI) and Yuri Fashions Co., Ltd., New York, N.Y., in support of H.R. 2225, a bill providing that certain wearing apparel imported from insular possessions of the United States, shall be treated for tariff purposes in accordance with the provisions of General Headnote 3(a) of the Tariff Schedules of the United States, as originally intended by that provision. Because of recent changes in the rules of origin used by the U.S. Customs Service for purposes of administering textile import quotas, imports of certain textiles and apparel from the insular possessions have now been subjected to quotas. This is currently the subject of litigation in The Court of International Trade[1]. The Customs Service has also proposed to extend these origin rules to general application for all tariff purposes. The assessment of duties and the imposition of quotas on imports from the U.S. territories, repudiates longstanding U.S. policy, rendering the lone infant CNMI industry completely uncompetitive with Asian producers, and virtually eliminating any opportunity for further development of this infant industry in an area which offers few employment alternatives. H.R. 2225 would preserve at least the duty-free treatment intended to apply to the

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1/ Yuri Fashions Co., Ltd. v. United States, Court No. 84-12-01807, U.S. Court of International Trade.

nascent apparel industry of the CNMI, and would re-affirm Congress' historical commitment to economic development of the insular possessions through the trade benefits embodied in Headnote 3(a) of the Tariff Schedules.

AIK is a manufacturer of sweaters in the Commonwealth of the Northern Mariana Islands (CNMI) and constitutes one-half of the industry in the CNMI. Yuri Fashions is a U.S. importer of apparel from the CNMI, usually from a different manufacturer. AIK began its operations on Saipan in 1984, producing acrylic sweaters from constituent materials originating elsewhere, since the capability was not present on the islands to draw and weave yarns for the manufacture of fabrics and apparel. AIK employs approximately 150 people and, of course, is a taxpayer of the CNMI. One important reason for AIK's presence in the CNMI, and for the attraction of private capital to any of the U.S. territories, is that articles imported from the insular possessions of the United States are accorded duty-free treatment pursuant to General Headnote 3(a) of the Tariff Schedules of the United States, as long as such products do not contain "foreign" materials, i.e., materials not originating in the possessions or the United States, which constitute more than 70 percent (50 percent in the case of textiles) of the value of the goods when they enter the Customs Territory of the United States. Guam and the Commonwealth of the Northern Mariana Islands are defined as "insular possessions" for purposes of General Headnote 3(a), and pursuant to Customs Service rulings, imports of sweaters produced in the CNMI have been treated as products of insular possessions for purposes of Headnote 3(a); as long as the apparel does not contain more than 50% foreign materials, it is accorded duty free treatment.

This form of tariff treatment reflects Congress' consistent historical recognition of the need for developmental trade benefits for the U.S. territories. The CNMI was part of the Trust Territories of the Pacific, and the Trusteeship Agreement directed that the United States "...promote the development of the inhabitants of the trust territory toward self government or independence". In 1975, the Northern Marianas entered into a Commonwealth covenant with the United States, approved by Joint Resolution of Congress, which reaffirmed the U.S. commitment to active promotion of the CNMI's economic development, and guaranteed duty treatment of the CNMI's goods no less favorable than that granted to Guam, i.e., Headnote 3(a) treatment. This treatment has been consistently applied to the CNMI in both Headnote 3(a) and the predecessor provision, Section 401 of the Customs Simplification Act of 1954.

In August 1984, the Customs Service departed from its prior interpretations of Headnote 3(a) and the legislative intent thereof by instituting new interim country-of-origin rules for the purposes of enforcing textile import quota limitations. Under these rules, as published in final form on March 5, 1985 (50 Fed. Reg. 8710), apparel which had previously been treated as a product of insular possessions is now considered a product of the country in which the component parts originated, despite the language of Headnote 3(a) to the contrary. Accordingly, the importation of such articles was made subject to the visa rules and quota limits applied to the components' country of origin. However, the Committee for the Implementation of Textile Agreements in March 1985 also established quantitative limits for sweaters assembled in the CNMI; within such limits, visa requirements would be waived and the imported sweaters would not be considered articles of the country in which their components originated, but rather, products of the CNMI for quota purposes. Under these contested regulations, all other apparel assembled in the CNMI must be treated as articles of the country from which the components originated, subject to those countries' quotas.

The Customs Service has now proposed to limit even further, if not eliminate entirely, the intended benefits of Headnote 3(a) by adopting these quota origin rules for all purposes, including marking and duty assessment. Thus, even with the "special" treatment of sweaters from the CNMI for quota purposes under the limitation published by CITA, such sweaters and all other apparel which meets the value test set forth by Congress in Headnote 3(a), would nevertheless apparently become dutiable as articles of the country of origin of the component parts. In other words, this two-step regressive administrative process of imposing quota-origin and dutiability-origin rules, accompanied by the establishment of import limits for certain apparel from CNMI as an "exception" to the quota origin rules otherwise made applicable to all other apparel assembled in the CNMI, leads to only one conclusion: the special developmental treatment of Headnote 3(a) intended specifically by Congress to apply to products from the CNMI and other insular possessions, has been administratively rescinded, rendering the insular possessions of the United States "foreign" textile countries.

H.R. 2225 represents a modest effort to correct this defacto reversal of longstanding Congressional policy toward the CNMI and other insular possessions. As proposed, it would require at the very least that the apparel production operations being conducted in the CNMI would be treated as sufficient to allow such apparel to be considered products of insular possessions for purposes of Headnote 3(a). The 50% value test would still have to be met, assuring simply that Headnote 3(a) is applied at least to certain products now being produced in the insular possessions as it was originally intended by Congress.

Other members of the U.S. apparel industries, namely, those located on the mainland of the United States, have pressed for the virtual withdrawal of Headnote 3(a) treatment for textiles from the small and undeveloped U.S. territories on the argument that the insular possessions can be used as transshipment points, where no significant processing is performed, for products from the Far East, and that no effective enforcement of U.S. textile quota rules is possible. Mainland producers may also be concerned about the growth potential for these industries and future increased competition from territorial manufacturers. We believe these problems are illusory; any concerns related to enforcement have already been addressed, and certain natural constraints prevent the CNMI industry from ever posing a realistic competitive threat to mainland producers.

First, officials of the U.S. Customs Service are located in the CNMI and can readily detect any fraud or avoidance of U.S. duty and country-of-origin laws. Second, the volume of imports which are the subject of the industry's concerns is negligible, and the likelihood of growth of these operations to a level sufficient to pose any competitive threat to mainland producers is very slight. In 1985, imports of sweaters from the CNMI in the relevant MFA categories accounted for less than ½% of 1% of total U.S. imports. Such levels do not present any credible threat of import injury, either now or in the foreseeable future. Furthermore, the opportunities for expansion of the industries in the insular possessions are extremely limited. The CNMI strictly controls immigration, so there can be no large influx of foreign nationals to control jobs created by these manufacturers. Legal and natural limitations prevent any large scale expansion: employers are required to comply with U.S. labor laws concerning wages and working conditions; water, electricity, and the absence of necessary elements of industrial infrastructure establish practical limits on the ability of CNMI producers to expand production to levels which threaten mainland producers.

In summary, H.R. 2225 would merely permit the nascent apparel industries of the insular possessions to benefit from the treatment intended under Headnote 3(a), without posing a threat to mainland industries or opening opportunities for circumvention of quota rules through transshipment or processing inadequate to meet the 50% test of the Headnote.

We applaud the fact that the Administration has "strongly supported" the purposes of H.R. 2225 in meeting U.S. undertakings with respect to the insular possessions. Long-standing territorial policy of the United States should not be disrupted by the promulgation of administrative inconsistencies with respect to the textile quota program and Headnote 3(a). However, we cannot support the proposed amendment of the Administration, to convert H.R. 2225 from a clarification of Headnote 3(a) into a modified quota-waiver TSUS item with a ten-year duty suspension for certain apparel items certified to have been assembled by companies within the possessions who have "local labor" content of at least 55% in the first year, increasing to 85% by the fourth year. Our opposition to this Administration proposal is based on two concerns.

First, the proposal implicitly accepts the premise that apparel assembled in the CNMI which meets all the criteria of Headnote 3(a) can and should be subject to Customs' quota origin rules and dutiability origin rules, and then excepted from those rules for a limited period of time, while still being subject to the "special" quota limits for articles assembled in the CNMI. This proposal amounts to a tacit contention by the Administration that Headnote 3(a) should not be applied as intended by Congress to apparel produced in the CNMI and the insular possessions, but rather that such apparel should be treated as a product of a foreign country with special dispensation from duties for a limited period of time. This represents a basic withdrawal from U.S. territorial policy with respect to a circumscribed class of goods and would render Headnote 3(a) meaningless with respect to such goods.

Second, the proposal undermines the most fundamental tenets of territorial policy through the imposition of scheduled minimum local labor requirements. While the representatives of the sweater industry on Guam have indicated that all of its employees are U.S. citizens, there is necessarily a start-up period during which some skilled foreign labor is necessary to establish the indigenous industries encouraged by Headnote 3(a) treatment. The sweater industry in Guam was established in 1981; the CNMI industry was not formed until 1984. The initial operations have of necessity relied upon foreign laborers temporarily located in the CNMI in order to establish the production facilities and train local laborers. As the representative of Guam's Sigallo-Pac testified, at the outset of their operation "there was not a single trained sewing machine operator in Guam...it was necessary to bring in supervisory and training people from the U.S. mainland". Likewise, it has been necessary for AIK to use some non-local residents to begin its operations, with the goal of hiring and training more local labor. This developmental stage may be somewhat lengthier than that experienced by the Guamian industry since the CNMI's population of approximately 16,000 is less than 20% of Guam's population, and far fewer skilled laborers are available. However, the fact that the early stages of industrial development of an insular possession require substantial non-local labor participation should not preclude the benefits of Headnote 3(a). The policy behind U.S. treatment of articles imported from possessions is to encourage industrial development and economic independence, a process which cannot occur overnight. Surely, a principal goal of such treatment should be the increased employment of local residents. The Administration proposal, however, would place a strict schedule on such development: 55% local labor the first year, 65% the second year, 75% the third year, and 85% thereafter. This amounts to nothing more than an arbitrarily imposed time-table for economic development which, if not met, exacts the automatic penalty of foreign country status, with its attendant harsh quota and duty limits. Such a result would effectively cut off the territory from any opportunity for development of that industry, regardless of the circumstances surrounding the industry involved or the local problems encountered by the companies. If the United States hopes to encourage the development of these possessions, a strict timetable for development should not be enforced in the manner suggested by the Administration's proposal.

The practical impact of this local labor content schedule, at the CNMI's current initial stages of development, would be the elimination of the industry. The sweaters imported from AIK's plant would not be eligible for duty free treatment under the proposed temporary duty suspension tariff provision and they could not compete with other imports. AIK would be forced to reduce or eliminate its facilities, the CNMI would lose an important tax revenue base, and the meager local labor opportunities would be reduced further. Unlike worker layoffs in foreign countries, however, residents of the CNMI are entitled to all financial assistance and compensation to which any U.S. citizen is entitled. Thus, eliminating these jobs does not eliminate the financial impact of territorial underdevelopment on the U.S. Treasury.

For these reasons, American International Knitters and Yuri Fashions Co., Ltd. urge the Subcommittee on Trade and the Committee on Ways and Means to reject the proposed substitute bill of the Administration, as developed by the Department of the Interior, and to report favorably on H.R. 2225 as introduced by Representatives Blaz and Frenzel.

Respectfully submitted

Andrew P. Vance

BARNES, RICHARDSON & COLBURN
Andrew P. Vance
Matthew T. McGrath

Counsel to

AMERICAN INTERNATIONAL KNITTERS
YURI FASHIONS CO., LTD.

February 13, 1986

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March 4, 1986

Honorable Sam M. Gibbons
Chairman
Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
Longworth House Office Building
Room 1136
Washington, D.C. 20515

Re: H.R.2225; Apparel from the Insular Possessions

Dear Chairman Gibbons:

We hereby supplement the statement filed on February 13, 1986, on behalf of American International Knitters ("AIK") and Yuri Fashions Co., Ltd. ("Yuri") in support of H.R. 2225 and in opposition to the proposed substitute measure of the U.S. Department of the Interior. Since the statement on behalf of these companies was filed within the comment period established in Subcommittee Release No. 15, it is respectfully requested that this letter correcting an inaccuracy in that submission be accepted and included in the Subcommittee's record of comments on the bill.

AIK, a manufacturer of sweaters in Saipan, CNMI, and Yuri, support H.R.2225 as introduced by Congressmen Frenzel and Blaz, since this legislation would provide that certain wearing apparel imported from the Commonwealth of the Northern Mariana Islands would be treated for tariff purposes in accordance with the provisions of General Headnote 3(a) of the Tariff Schedules of the United States, as originally intended by Congress, but which treatment has been denied by administrative action during the past two years.

AIK and Yuri oppose the proposal by the Administration to introduce an amendment in the nature of a substitute which would establish a separate *eo nomine* tariff item for sweaters assembled in Guam or the CNMI, with a limited period of duty suspension as long as prescribed, annually progressive, minimum local labor content percentages are reached by enterprises producing such sweaters. One of the reasons provided in the February 13 statement for this opposition is that the CNMI industry has only recently been established, and an initial start-up period with somewhat lower expectations for local labor content should be anticipated for any geographically isolated enterprise requiring skilled labor. The Guamanian industry, on the other hand, has already been established, and has a larger pool of local labor from which to draw.

In the February 13 statement, it was erroneously stated that the sweater industry on Guam was established in 1981. However, we are now advised that this was the year in which the company Sigallo-Pac was established on the island. The Guam sweater industry actually predates that company's arrival by at least five years. Thus, the Guamanian sweater industry, in addition to its larger available labor market, has the advantage of a longer period of establishment and development, and may, therefore, more easily meet the 55-85% local labor requirement proposed in the Administration substitute bill. The CNMI industry, on the other hand, has been formulated almost entirely in the last two years. It would be unreasonable to expect it to meet an immediate 55-to-85% local labor requirement, and would be contrary to the developmental intent of Headnote 3(a) to deprive the CNMI of duty-free treatment for failure to reach such a standard immediately. It is doubtful that the industry in Guam could have fulfilled this proposed standard at a comparable stage of development, yet the Administration now proposes an amendment purporting to preserve Headnote 3(a) treatment for Guam while depriving the CNMI of the opportunity to develop. This is unfair and illogical, and fails to accord with prior Congressional intent or enunciated Administration territorial policy.

American International Knitters and Yuri Fashions urge the Subcommittee to report favorably on H.R.2225 as proposed by Congressmen Frenzel and Blaz, and to reject the substitute amendment proposed by the U.S. Department of the Interior, or any other substitute measure imposing a comparably re-strictive labor content requirement.

Respectfully submitted,

Andrew P. Vance
Matthew T. McGrath

Counsel to:
AMERICAN INTERNATIONAL KNITTERS
YURI FASHIONS CO., LTD.

H.R. 2336

To impose a duty on uranium hexafluoride (UF_6) imported from any country that requires the processing of uranium mined in that country into UF_6 before export.

No statements received.

H.R. 2349

To amend the Tariff Schedules of the United States regarding the classification of television apparatus and parts thereof.

1. The Committee to Preserve American Color Television ("COMPACT") is an unincorporated association comprised of manufacturers in the domestic television industry and labor organizations, which represent the overwhelming number of workers in the domestic television industry.

2. COMPACT urges passage of H.R. 2349, which would add an Interpretive Headnote to the Tariff Schedules requiring that color television picture tubes, imported in combination with other articles, be classified under the separate provision for television picture tubes, dutiable at 15 percent.

3. The legislation would put an end to the circumvention of the higher duty on the picture tube by eliminating a loophole in the Tariff Schedules that enables picture tubes, imported in combination with other articles, to be classified as incomplete television receivers, dutiable at 5 percent.

4. The loophole was first used by Matsushita Industrial Company of Franklin Park, Illinois, which since May 1982 has been importing substantial quantities of color television picture tubes manufactured in Japan and shipped to its assembly facility in Mexico.

5. Matsushita transships the picture tubes to the United States together with chassis and control panels assembled at its Mexican plant. Upon importation, the picture tube, the chassis and control panel are incorporated into a color television receiver. Final assembly requires the addition of cabinet, a deflection yoke and speakers, and in some instances a degaussing coil, as well as other parts and components.

6. While the picture tube is transshipped through Mexico, it is never removed from its original factory packaging until it arrives in the United States.

7. COMPACT has challenged a ruling by the U.S. Customs Service, which has determined that the entire importation should be classified under the tariff schedule provision for television receiver assemblies, dutiable at a rate of 5 percent. The challenge was denied.

8. Since it began exploiting the loophole in the Tariff Schedule, Matsushita's imports from Mexico have grown 444 percent between 1982 and 1985. Prior to May 1982, there were no such entries of these articles.

9. Use of the loophole has resulted in a loss to Customs of approximately $8 million in revenue based on the duty that would have been collected on the value of the picture tube were it classified separately as Congress intended.

10. H.R. 2349 ensures that the intent of Congress, that television picture tubes be dutiable at 15 percent, is not circumvented and ensures that U.S. picture tube manufacturers are permitted to compete with foreign manufacturers on terms which are consistent with the intent of Congress.

STATEMENT ON BEHALF OF THE COMMITTEE TO PRESERVE AMERICAN COLOR TELEVISION

BEFORE THE
SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

This statement is submitted on behalf of the Committee to Preserve American Color Television ("COMPACT"), an unincorporated association made up of manufacturers in the domestic television industry, and eleven labor organizations which represent the overwhelming number of workers in the domestic television industry including workers engaged in the manufacture of materials, parts and subassemblies irrevocably destined for incorporation in television receivers and color television picture tubes, as well as workers engaged in the final assembly of color television picture tubes and finished television receivers. The list of COMPACT members is attached to this statement (see Appendix A).

COMPACT strongly urges the passage of H.R. 2349, now before the Subcommittee. COMPACT submitted a more detailed statement in support of this bill in June 1985. This statement reaffirms that support. H.R. 2349 would add a new Interpretive Headnote to the Tariff Schedules which would require that color television picture tubes, imported in combination with, or incorporated into other articles, be classified under the separate provision for television picture tubes, unless they are incorporated into complete television receivers or in kits containing all of the parts necessary for assembly into complete television receivers.

While the changes embodied in H.R. 2349 are technical in nature, the purpose underlying the legislation is critical to the survival of the domestic industry. H.R. 2349 would ensure that color television picture tubes, imported separate from, but in connection with various subassemblies of television receivers, are classified under the separate provision for television picture tubes, dutiable at 15 percent. The legislation would ostensibly put an end to the circumvention of the higher duty on the picture tube by eliminating the loophole that enables such entries to be classified as incomplete television receivers, dutiable at a rate of 5 percent.

The Subcommittee is familiar with the long history of the domestic television industry's battle against unfairly traded imports. It is aware of the endless findings of dumping against foreign television manufacturers, and it is aware of the numerous determinations by the U.S. International Trade Commission that there has been injury to the domestic television industry as a result of dumped imports. Congress has been supportive of the industry's efforts to seek relief from these unfair practices. The problem has been exacerbated, however, as foreign manufacturers have attempted to avoid the various antidumping orders now in effect through third country and U.S.-based assembly operations. Only Congress can provide an effective and expeditious solution to this type of problem.

The nature of the problem can best be described in light of COMPACT's recent experience with the U.S. Customs Service in attempting to overturn an administrative ruling conferring legitimacy on the tariff loophole.

Since May 1982, Matsushita Industrial Company ("MIC") of Franklin Park, Illinois, has been importing substantial quantities of color television picture tubes manufactured in Japan and shipped to its assembly facility in Mexico. Each television picture tube is subsequently transshipped to the United States together with a chassis and control panel which were assembled at the Mexican plant. Following their arrival at Matsushita's television assembly plant in the United States, the television picture tube from Japan, and the chassis and control panel assembled in Mexico, are incorporated in color television receivers assembled by MIC. Final assembly of these color television receivers requires the addition of a cabinet, a deflection yoke and speakers, and in some instances a degaussing coil, as well as other parts, assemblies and components.

No manufacturing operations are performed on the picture tube after it leaves Japan. When the chassis and control panel come off the Mexican assembly line and are packed on the truck for shipment, MIBA places the Japanese TV picture tube (still in its original carton) is placed on the same truck, one per assembled chassis and control panel. The final importation will consist of three entities: two of which were products of Mexico as a result of a Mexican assembly operation -- the assembled chassis and assembled control panel -- and one that is the product of Japan with no work performed in Mexico -- the television picture tube. The U.S. Customs Service determined in September 1981 that the entire importation would be classified under the tariff schedule provision for television receiver assemblies (including kits) with picture tubes dutiable at a rate of five percent ad valorem. The ruling was made not withstanding the fact that the picture tube never leaves the original factory carton.

Approximately eight months after the Customs ruling, imports of "television receiver assemblies (including kits) with picture tubes" began entering the United States from Mexico, and those imports have continued to come in at an ever increasing rate. Prior to May 1982, such imports were non-existent. In 1985, these Mexican imports had grown to over 640,000 units. (See Appendix B.)

On September 19, 1983, four labor organizations, which are members of COMPACT, and which represent workers engaged in the production of color television picture tubes, filed a petition challenging the tariff schedule loophole that permits Japanese color television picture tubes, imported from Mexico in their original cartons with assembled chassis and assembled customer control panels, to be classified as color television assemblies, dutiable at 5 percent. The petitioners contended that the color television picture tubes included in these importations should be entered separately as products from Japan under item 687.35, TSUS, dutiable at a rate of 15 percent. Notwithstanding the arguments put forth by the domestic industry, Customs denied the petition.

COMPACT believes that unless action is taken soon to rectify this situation, the damage that will be caused by the continued exploitation of the loophole will be irreparable. Already the exploitation of the loophole has resulted in a loss to Customs of approximately $8 million in revenue, based on the amount of duty that would have been collected on the value of the picture tube were it classified separately. Of even greater concern to COMPACT, however, is the 444 percent growth in imports of incomplete receivers from Mexico that has taken place between 1982 and 1985, and the prospects that other foreign producers will establish perfunctory U.S. assembly operations like Matsushita in order to exploit the loophole.

H.R. 2349 is the most direct and fair way to eliminate the loophole. The legislation does not create new tariff categories, nor does it alter the level of duty on existing categories. Accordingly, it is consistent with our international obligations and agreements. The legislation merely ensures that the intent of Congress -- that television picture tubes be dutiable at 15 percent -- is not circumvented, and that the U.S. picture tube industry is permitted to compete with foreign manufactures on terms which are consistent with that intent. For these reasons, COMPACT respectfully requests that the Subcommittee give the legislation immediate and favorable consideration.

Appendix A

MEMBERS OF THE COMMITTEE TO PRESERVE AMERICAN COLOR TELEVISION

Allied Industrial Workers of America, International Union

American Flint Glass Workers Union of North America

Communications Workers of America

Corning Glass Works

Glass Bottle Blowers' Association of the United States and Canada

Independent Radionic Workers of America

Industrial Union Department, AFL-CIO

International Association of Machinists

International Brotherhood of Electrical Workers

International Union of Electronic, Electrical, Technical, Salaried and Machine Workers, AFL-CIO

Owens-Illinois, Inc.

United Furniture Workers of America

United Steelworkers of America

Wells-Gardner Electronics Corporation

Appendix B

U.S. IMPORTS FOR CONSUMPTION OF COLOR TELEVISION 1/ FROM MEXICO, ANNUAL 1982 - 1985

	(in units)
1981	0
1982	117,756
1983	413,028
1984	502,305
1985	640,980

1/ TSUSA item 685.1455 through 1984. TSUSA item 684.9655 beginning 1985.

Source U.S. Department of Commerce data, IM146 and IM145X.

WRITTEN STATEMENT OF CLARENCE L. PERRY ON BEHALF OF THE TUBE DIVISION, ELECTRONIC INDUSTRIES ASSOCIATION

BEFORE THE SUBCOMMITTEE ON TRADE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

1. The Tube Division of the Electronic Industries Association is comprised of companies who represent the bulk of the production of color television picture tubes in the U.S., as well as producers of the glass components.
2. The Tube Division urges passage of H.R. 2349, which will close the loophole that has enabled foreign manufacturers to circumvent the 15 percent duty on color television picture tubes ("CPTs") by importing CPTs as part of unassembled sets or kits.
3. Use of the loophole has resulted in an average annual growth of 192 percent of CPTs imported as part of a kit or incomplete receiver.
4. Matsushita has been the principal user of the loophole with its Mexican assembly operation.
5. Impact of the loophole on Owens-Illinois ("O-I") has been severe.
    - In second half of 1985, O-I customers have cut back tube production by 900,000 - 1,000,000 tubes.
    - O-I sales of color glass parts are down 14 percent.
    - O-I must reduce total number of salaried employees by about 15-20 percent.
    - 20 percent decrease in production is occurring at O-I's Pittston, Pennsylvania plant despite the bringing on line of a new furnace.
6. Exploitation of the loophole is a major cause of these adverse developments.
7. Tube Division of EIA requests the Subcommittee to move quickly to eliminate the loophole, which threatens the survival of the picture tube industry.

Mr. Chairman,

My name is Clarence L. Perry. I am Vice President and General Manager of the Television Products Division of Owens-Illinois. I am pleased to submit this written testimony on behalf of the Tube Division of the Electronic Industries Association ("EIA") in support of H.R. 2349, a bill to amend the Tariff Schedules of the United States with respect to the classification of color television apparatus and parts thereof.

The Tube Division of EIA is comprised of companies who represent the bulk of the production of color television picture tubes in this country, as well as producers of the glass components used in such tubes. Our membership includes General Electric Company, North American Phillips Corporation and Zenith Radio Corporation, each of which manufactures color television picture tubes ("CPTs"); Corning Glass Works and Owens-Illinois, Inc., each of which manufactures glass parts for CPTs; and RCA Corporation, which manufactures both CPTs and glass parts for CPTs.

The Tube Division of EIA strongly urges your support for passage of H.R. 2349. Enactment of H.R. 2349 will close the loophole in the Tariff Schedules, which has enabled foreign color television set manufacturers to import color television picture tubes as part of an unassembled set or kit at 5 percent duty, rather than at the 15 percent rate established by Congress. The significance of that loophole, and the extent to which it has been exploited, is reflected in the import statistics for these items. In 1982, there were 162,144 color picture tubes imported as part of a kit or incomplete television receiver, with the number growing to 539,593 in 1983, 643,948 in 1984, and 1,094,048 in 1985. This constitutes an average annual growth rate of 192 percent.

Until recently, most of these kits have come through Mexico, where Matsushita Industrial Company has been importing single packages containing chassis and control panels for television receivers assembled in Mexico, in combination with separately-packaged color television picture tubes manufactured in Japan. By importing these item in the same entries, Matsushita is able to circumvent the 15 percent duty on color picture tubes by merely declaring a single entry as an unfinished television receiver, dutiable at 5 percent. Ironically, the picture tube, which comprises almost 50 percent of the value of the entry, is imported in its original factory packaging. The unopened package is merely transshipped through Mexico where it is paired for shipping purposes only with a package containing the Mexican-assembled chassis and control panel. H.R. 2349 will eliminate the loophole that has given rise to this practice by requiring that a television picture tube, imported in combination with other articles, be classified under the separate provision for television picture tubes, unless it is incorporated into a complete television receiver.

The compelling need for this legislation can be ascertained by considering the damage the loophole has caused in connection with my own company, Owens-Illinois. During the second half of 1985, our customers, the color picture tube manufacturers, cut back their production by 900,000 to 1,000,000 tubes. It is therefore no surprise that between 1984 and 1985, sales of color glass parts by Owens-Illinois declined by 14 percent. The Subcommittee cannot ignore the fact that these declines are taking place at the same time that over one million tubes are entering this country as a direct result of the loophole.

The import problem, exacerbated -- indeed facilitated by this loophole -- has also had a devastating impact on workers within the company. In order to maintain its competitive position, Owens-Illinois must reduce the total number of salaried employees in the Television Products Division by about 15-20 percent. The principal reason for this proposed reduction, as publicly announced by our Director of Personnel: importation of tubes and unassembled kits by Japanese and Korean manufacturers with assembly plants here in the U.S. These cutbacks, while they are the most significant yet, are merely the continuation of a trend, whose outset is contemporaneous with the large-scale use of the Tariff Schedule loophole. That downward trend has been reflected in, among other things, a reduction of 255 jobs in our Columbus, Ohio plant. It has also been reflected in the shutting down of one furnace and two forming lines at our plant in Pittston, Pennsylvania. The shutdown will result in a 20 percent decrease in production and will affect jobs. Ironically, Pittston brought a new furance on line in August 1985 to manufacture color television panels. The new furnance is not needed today.

The legislation before you does not seek protectionist solutions. It merely seeks to ensure that the law, as embodied in our Tariff Schedules, is not evaded through the innovative fashioning of import shipments in a manner that clearly exceeds the bounds of congressional intent. It would be inexcusable to see the picture tube industry become the inadvertent victim of a technical loophole in the Tariff Schedules, a loophole that has already resulted in a substantial loss of jobs, and in one instance, to a 20 percent reduction in the work force of one of the largest producers in the industry.

The Tube Division of EIA asks the Subcommittee to move quickly on this matter. While the changes embodied in the legislation are technical in nature, they are critical to the future of this industry; indeed, they are at the very heart of its survival.

Harvey Industries, Inc.

James H. Conley
President

February 13 ,1986

FEB 14 1986
WAYS AND MEANS

VIA FEDERAL EXPRESS

Mr. Joseph K. Dowley
Committee on Ways and Means
U. S. House of Representatives
Room 1102 LHoB
Washington, D.C. 20515

Reference: H.R. 2349

Dear Mr. Dowley:

I understand that the Committee on Ways and Means is about to make a determination in connection with the above-referenced bill, as to whether picture tubes imported from other countries as part of unassembled television kits should be assessed higher duties than the 5% presently in the existing tariff schedule.

I am President and Chief Executive Officer of Harvey Industries, a Texas-based company which has operated as an OEM manufacturing company of television receivers since 1982. We currently employ approximately 1100 persons in Athens, Henderson County, Texas, and are the largest employer in the county. I personally have had extensive executive experience in the television industry. I spent more than six years with Magnavox, five years with RCA, five years with Zenith and two years with Curtis Mathes before joining Harvey Industries in 1982. Harvey Industries is 100 percent owned by Ray Harvey, who was with Curtis Mathes for 25 years, the last five as President of the Curtis Mathes Sales Company.

We are currently producing OEM televisions for NEC, Samsung and others, including Curtis Mathes. NEC and Samsung supplies us with television components which we assemble into television receivers. Although I have no legal experience or customs law experience, I would suggest that a redefinition of the existing tariff schedule and its provisions would be extremely negative for our company and consequently, our community.

It is difficult for our Company to understand the particularly narrow thrust of the Ways and Means Committee when there is not a single U.S. company still producing chassis in the United States. Moreover, many U.S. companies are also importing picture tubes and completed televisons from outside the U.S.

A change to the existing tariff regulations as covered in H.R. 2349 may lead many foreign companies to eliminate or severely curtail their U.S. production operations, including their contracts with us. We hope that you will take this into account in making your decisions.

Sincerely,

JHConley

J. H. Conley
President and Chief Executive Officer

Ah

Flat Creek Road • P. O. Box 2096 Athens, Texas 75751 (214) 675-2121

STATEMENT OF
IVA M. WILSON, PRESIDENT
PHILIPS ECG, INC.
50 JOHNSTON STREET
SENECA FALLS, NEW YORK

Summary of Comments and Recommendations

Philips ECG, Inc. strongly supports H.R. 2349 and urges that the Bill be reported favorably out of this Committee.

H.R. 2349 would close a pernicious loophole in the Tariff Schedules created by an incorrect administrative ruling which has had the effect of permitting the importation of color television picture tubes at a 5% duty rate as opposed to the 15% duty rate intended by Congress.

Mr. Chairman and Members of the Committee:

My name is Iva Wilson and I am President of Philips ECG, Inc., which is the cathode ray tube manufacturing operation of North American Philips Corporation. North American Philips Corporation is a New York Stock Exchange company. Fifty-eight percent of the stock of North American Philips Corporation is owned by the Connecticut National Bank as Trustee of the U.S. Philips Trust whose beneficiaries are the shareholders of N.V. Philips of the Netherlands. North American Philips acquired the "Sylvania" and "Philco" consumer electronics and cathode ray tube businesses of GTE Corporation in 1981.

I know, Mr. Chairman, that the members of the Committee have already received verbal and written testimony from other members of the consumer electronics industry on this subject and I do not wish to go over old ground. Suffice it to say that Philips ECG totally disagrees with the convoluted reasoning which has formed the basis for the current ruling which permits color television tubes to enter the U.S. at 5% duty rather than the Congressionally proscribed 15% rate.

I would, however, like to comment in a few specific areas concerning the practice which H.R. 2349 seeks to end, and the real consequence that this loophole has had on the U.S. television tube industry as opposed to some of the speculative effects suggested by those who oppose this Bill.

First, as to the scheme itself, I wish to point out to the Committee that the basic methodology for taking advantage of this loophole merely involves the trans-shipment of Japanese (or presumably any other foreign manufacturer's) television tubes into Mexico and their re-importation into the U.S. with an identical quantity of television electronics. The Japanese television tubes in this case are not even removed from their original packaging material. It is my understanding that virtually no activity whatsoever takes place with respect to these tubes in Mexico. Rather, the separate packing cases of tubes and electronics are loaded into a trailer and shipped to the assembly plant in Illinois.

Further, there is absolutely no evidence I am aware of that has been offered to show that these tubes and the specific television electronics they are imported with are ever brought together again to form a television set. The tubes in question are presumably placed into the manufacturer's inventory and used in production as required. By using the administrative loophole which is the subject of this Bill, however, these foreign-made television tubes avoid the Congressionally approved 15% duty rate, and, if this scheme is not stopped, ultimately threaten the survival of the domestic television tube industry.

Let me turn to the impact this loophole is having on the U.S. television tube industry. In order to do so, one must look at the world situation, as consumer electronics is clearly a global business. In the world market for color television tubes a condition of over-capacity, principally in the Far East, exists. As a result of such over-capacity, since the early 1980's Japanese and Far East color television tube manufacturers have looked to the U.S. market. The brunt of the impact on U.S. television tube manufacturers first fell on the 13" screen size which historically has been the backbone of the tube industry in the Far East. The result has been the virtual demise of the manufacture of that screen size in the U.S. The 19" television tube represents the largest volume of the U.S. market and has apparently now been targeted as the next area of opportunity. If the 19" market goes the way of the 13", the U.S. picture tube industry will be dealt a fatal blow as survival on the larger screen sizes alone is, in my view, impossible. The Congressional intent evidenced in exempting color tubes from multilateral trade negotiations and preservation of the 15% duty will have been totally foiled.

It is also evident from testimony already before this Committee that the U.S. picture tube industry has not benefitted from the widely publicized increases in U.S. television sales over the last several years.

In fact, virtually all of the growth in this market as been in imports with foreign tubes now accounting for almost half of all of the tubes used in sets sold in the U.S.

We calculate the recent decline in U.S. CRT production and the U.S. picture tube industry's loss of market share between 1984 and 1985 at well over two million units. The loss of these two million units has had a devastating effect on the profitability of an industry that has historically been characterized by the need for heavy capital expenditures and high volumes just to break even. The pressure from foreign tubes and foreign over-capacity has already affected my Company as witnessed by our 1985 closure of manufacturing operations in Seneca Falls, New York and the consolidation of such operations into our Ottawa, Ohio facility with the resulting net loss of approximately 700 jobs. I am not suggesting that the Customs decision at issue here was the sole cause of our decision to consolidate. It was, I believe, symptomatic of the competitive weakness of the U.S. industry when compared with the over-capacity conditions of the Far East. These are factors which Congress clearly intended to provide for with the 15% duty on color television tubes. Actions such as those recently taken by Philips ECG can only be expected to be repeated at other U.S. tube makers if the 15% duty rate on picture tubes is "gutted" by this loophole.

Finally, I wish to say that over the years Philips ECG and its predecessor companies have been suppliers of color television picture tubes to almost all U.S. manufacturers of televisions (as opposed to integrated television and tube manufacturers such as RCA, Zenith and GE). During this period we have always been competitive in the important areas of quality and price and we will continue to be competitive in quality, products and prices in the future. The loophole created by this misguided administrative decision, however, unfairly threatens the continued existence of the U.S. television tube industry and the jobs of thousands of U.S. workers.

I urge you to report this bill favorably out of your Committee and to restore the 15% duty rate the Congress intended to apply to the import of color television tubes.

Statement of D. Joseph Donahue, Vice President, Consumer Electronics Operations, RCA Corp.

I am pleased to have the opportunity to express RCA Corporation's strong support in favor of passage of Congressman Rostenkowski's bill, H.R. 2349.

As a pioneer U.S. manufacturer of television receivers, television picture tubes, and other electronic products, RCA has been active in the color television business since 1954. But today, RCA is one of the few remaining U.S. manufacturers in the consumer electronics industry.

Twenty years ago there were dozens of U.S. manufacturers. Today the list has dwindled to three majors, Zenith, General Electric, and RCA. On the other hand, there are approximately 40 different foreign brands participating in the U.S. marketplace. These foreign brands design their products and produce much of the components outside the United States. Further, some receive preferential duty treatment under what RCA perceives as a misinterpretation of the U.S. tariff statutes.

Our concern is that a domestic television industry, already sharply reduced in employment levels, will shrink even further or disappear altogether unless laws already mandated by Congress are not observed fairly by all participants.

H.R. 2349, introduced by Congressman Rostenkowski, would remedy this situation. It was never intended in 1977 and 1980, when Orderly Marketing Agreements were entered into, first with Japan and later with Taiwan and South Korea, to change the dutiable status of color television picture tubes that are not part of complete television receivers.

We believe the tariff statutes clearly indicate the picture tube duty rate, as prescribed by Congress, was intended to be 15% and not reduced to 5% by a cynical and incorrect misinterpretation of the term "kits".

It is clear to RCA that the tariff statute language, which provides the so-called basis for classification of "kits" at 5%, was never intended for that purpose. We believe it was introduced into the tariff statutes for the sole purpose of enabling Customs to monitor quotas under the Orderly Marketing Agreements.

However, when these OMAs came to an end in mid-1982, the "monitoring" language did not likewise disappear, and that is one problem the passage of H.R. 2349 will remedy.

Earlier, I referred to a misinterpretation of the term "kits". It is appropriate at this point to note for the record that "kits" is a misnomer. What we in fact are dealing with is not "kits", since nearly 50 additional components are separately sourced by importers and added to the "kits" to produce color TV receiver chassis in the United States

If you or I as a hobbyist purchased a "kit" and found nearly 50 parts missing, we would both agree the definition of a "kit" had been stretched too far.

Yet, the number of color television kits flowing into the U.S. from outside the country has been climbing each month, helped along by a lower, unfair duty rate on the principal component, the picture tube.

The dutiable status of color picture tubes is a crucial element in the survival of U.S. color television receiver manufacturers. The color television picture tube is the single most costly component in the manufacture of color television receivers. It amounts to some 55% of the material value of a television receiver and 38% of the value of the finished receiver. For a 19" diagonal color receiver, the cost of the picture tube ranges from approximately $70-80. This means that an importer who receives the benefit of this misinterpretation of the tariff statutes (i.e., reduction of duty rate from 15% to 5%) is accorded a cost benefit of $7-8 per color receiver in a highly competitive business where retail prices are below 1967 prices.

RCA is fully prepared to continue participating in the intensely competitive consumer electronics market, and we are constantly taking steps to do so by use of advanced manufacturing technology and increased productivity. However, we sincerely believe the existing interpretation of "kits" is incorrect and unfair, and we therefore urge that H.R. 2349 be passed by the Congress.

Closing this loophole will materially aid a price-depressed color television industry, already decimated by years of low priced labor competition from the Far East.

In RCA's own situation in the United States, specifically in the State of Indiana which is the headquarters of our consumer electronics business, we constantly are dealing with this intensely competitive situation.

In the past five years RCA consumer electronics employment has decreased nearly 50%. I would not presume to suggest to you that the customs classification of "kits" is the sole cause for this decline, because it is not. I would suggest to you though that it is a contributing factor that will ultimately affect our total color television business—receivers and picture tubes—that employs some 12,000 in Pennsylvania, Ohio and Indiana.

I appreciate the opportunity to express RCA's views in support of passage of H.R. 2349.

Thank you.

Sharretts, Paley, Carter & Blauvelt, P.C.
New York, NY, February 12, 1986.

Joseph K. Dowley,
Chief Counsel, Committee on Ways and Means, Washington, DC.

Dear Mr. Dowley: On behalf of Sanyo Manufacturing Company (SMC), we wish to state for the record our opposition to H.R. 2349, a bill which would effectively increase by 200 percent the import duty on television picture tubes imported as a part of television sub-assemblies.

SMC, located in Forrest City, Arkansas, employs over 2,000 American employees in manufacturing color television sets and microwave ovens in the U.S. Since Sanyo acquired the former Warwick Electronics television manufacturing facility in Forrest City in 1976, it has substantially increased its production of television sets intended for the U.S. market, and has expanded employment to 2,000 from the 500 workers employed when SMC started operations. In fact, in constructing this facility, SMC's parent company in Japan transferred production lines from Japan to Forrest City, and SMC acquired other modern equipment to allow the production of sets in the most efficient manner possible.

Sanyo's decision to continue to produce color television sets intended for the U.S. market at SMC, rather than importing complete sets from Japan, is based on sound economic considerations. Sanyo has rationalized its television production by continuing to produce certain component parts in Japan, while sourcing many components from vendors located in the U.S. Moreover, many sub-assemblies are produced at SMC's own Forrest City facility and all the substantial assembly operations and final testing necessary to produce a color television set are performed at SMC. In this manner, SMC has been able to produce a high quality television set in as efficient a manner as possible so as to compete in the U.S. industry.

However, unlike most other U.S. producers of television receivers, Sanyo does not produce picture tubes and must therefore purchase them on the open market. In order for SMC to remain competitive it is essential that the price it pays for picture tubes, which it must buy from its competitors, be at realistic market prices. This is a critical point which must be fully understood. All sources of television tubes, both domestically and abroad, are themselves producers of television receivers in competition with Sanyo and SMC. Increasing the level of tariff protection for U.S. tube producers will limit SMC's negotiating leverage and, in all probability, lead to an increase in domestic (and imported) tube prices as alternative sources become less competitive. Japanese and American owned producers with captive tube sources will be able to minimize the effects of any increase in tube costs through intra-company pricing.

In 1984, the vast majority of all picture tubes used by SMC for the manufacture of television receivers in the U.S. were domestically purchased. However, domestic tube manufacturers have chosen not to produce certain tubes in the U.S., and SMC, like all U.S. television producers, must either import complete televisions in these screen sizes, or import a television sub-assembly in which the tube is physically incorporated. To date, in order to maximize U.S. production, SMC has adopted the latter alternative.

Thus in 1984, tubes imported by SMC were solely of sizes (5 inch) or types (mini-neck, fine pitch, flat/square, projection) not at that time produced in the U.S. In the instance of certain 25 inch tubes, SMC switched from a Japanese to a U.S. manufacturer in mid-year when the product became available domestically.

Even though SMC looks principally to domestic suppliers, an increase of duty from 5 to 15 percent on the relatively limited volume of tubes imported by SMC would have resulted in a income loss of approximately $1 million in 1984, and in fact would have caused the company to operate at an overall loss. Given the fiercely competitive nature of the U.S. television market, SMC would be unable to raise its prices on these sets to pass on their increased cost and would probably have to discontinue U.S. production of models requiring imported tubes, with a consequent loss of approximately 50 jobs in the U.S., and the idling of $1 million worth of plant and equipment in Forrest City. U.S. tube producers would gain nothing from SMC's loss since they are not producing these tubes, and SMC would be forced to consider importing finished television receivers so as to be able to offer a complete product line.

Like its larger domestic competitors, SMC might have to establish assembly facilities of its own in developing countries, such as Mexico.

SMC does not want to take these drastic measures, having spent considerable time and effort in establishing a production facility in Forrest City, Arkansas. SMC has trained a force of over 2,000 loyal American workers and has developed stable sources of supply of a wide variety of television components from many small domestic companies. A decision by Congress to effectively increase the import duty on television picture tubes to 15 percent—when the tubes imported by SMC cannot be obtained in the U.S.—will severely harm SMC, its workers, and its domestic suppliers.

It has been suggested that H.R. 2349 could be made more palatable by excluding from its coverage picture tubes not made in the U.S. While this proposal seems reasonable in concept, we believe it would be unworkable commercially. In a marketplace characterized by rapid technological development we do not believe it would be possible to create a mechanism which could be administered by the U.S. Customs Service, which would provide any certainty to importers. Thus SMC, when placing an order for picture tubes of a particular kind, needs to know whether the duty payable on importation some months later will be 5 percent or 15 percent. Furthermore, as noted above, a duty increase on tubes produced in the U.S. is bound to result in a price increase in domestically sourced products for consumers like SMC, who have no captive source of tubes. Other producers, whether Japanese or American owned, with captive production, are in a much better position to avoid such an increase.

It has been alleged that H.R. 2349 is required to close a loophole in the tariff schedules, resulting from a misinterpretation of the law by the U.S. Customs Service, which has frustrated the intent of Congress. We believe this allegation is based on ignorance of U.S. Customs law and procedure. In fact, if H.R. 2349 were to become law, the treatment of television receivers and their components would be the exception to the normal treatment of U.S. imports.

As succinctly summarized by the Customs Court, 70 years ago, in *Protest of A.T. Otto*, 31 Treas. Dec. 511, T.D. 36852 (1916), "if there is one principle of law which is so fundamentally established in Customs adjudication that it may truly be said to be axiomatic, it is that imported merchandise must be considered for tariff purposes precisely in the condition in which it is imported." The Court continued:

> We venture to say that no other rule of customs law has been more frequently reiterated, approved, and adopted by the courts + That it transcends in importance, if not in the order of priority, any other appropriate rule, is unquestionable, since to ignore it would reduce to chaos the administration of the tariff, in so far at least as the classification of merchandise is concerned.

This basic principle of law has withstood the test of time, and the Customs Service's decision that color television picture tubes imported as part of an assembly are subject to a five percent rate of duty merely applies this well established precept to a relatively simple set of facts and circumstances. Item 684.96 of the tariff schedules expressly includes "color television assemblies, having a picture tube." This statutory language is unambiguous; item 684.96, TSUS, clearly encompasses a picture tube imported as an assembly with other component parts of a television receiver. For Congress to create a new tariff provision which would require the Customs Service to classify picture tubes in a separate tariff provision notwithstanding the fact they are imported as part of a television assembly, would create a situation in which an imported article will no longer be classified in its condition as imported, in direct contravention of the most fundamental principle of Customs jurisprudence. Thus, rather than closing a loophole in the tariff schedules, H.R. 2349 would create an exception to a longstanding general rule of law.

For all these reasons, SMC believes that the passage of H.R. 2349, whether in its present form, or modified to exclude domestically produced picture tubes, would have a significantly adverse affect on its ability to operate profitably as a U.S. producer of television receivers. We therefore urge that the Ways and Means Committee not support passage of this legislation.

Sincerely,

Gail T. Cumins.

SHARP

SHARP MANUFACTURING CO. OF AMERICA
DIVISION OF SHARP ELECTRONICS CORPORATION
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FEB 13 1986
WAYS AND MEANS

February 10, 1986

Joseph K. Dowley, Esq.
Chief Counsel,
Committee on Ways and Means
U. S. House of Representatives
Room 1102 Longworth House Office Building
Washington, D. C. 20515

Re: Comments in Opposition to H.R. 2349

Dear Mr. Dowley:

Sharp Manufacturing Company of America, the U. S. manufacturing division of Sharp Electronics Corporation, employs 895 personnel in its two manufacturing plants in Memphis, Tennessee. 51.8% of these personnel are involved in the production of TV's.

As a U. S. employer, Sharp wishes to go on record as opposing H.R. 2349, a bill which would subject television picture tubes to a 15% Customs duty, unless they are incorporated into a complete television receiver or kit containing the entire television receiver including the cabinet. Under present law, television picture tubes imported with chassis and control panels are dutiable at 5%.

Sharp's opposition to H.R. 2349 is based on the following:

1. It would significantly increase the costs of a number of companies producing color television receivers in the United States. Because of the intensely competitive environment which prevails in the television industry, these increased costs could not be absorbed by the companies in question;

2. This would lead to a substantial net loss of U. S. jobs and a shift in employment to off-shore production;

3. We believe these conclusions would be substantiated by an economic analysis conducted by an impartial organization such as the General Accounting Office;

4. It would expose the United States to demands for compensation under GATT, since the 5% rate is "bound"; and

5. It would distort the normal rules of tariff classification.

Detailed statements in support of the above conclusions have been filed with the Committee on Ways and Means by other U. S. producers of television receivers.

Sincerely,

S. Okamoto

Shinichi Okamoto
President

STATEMENT OF
Robert Traeger, Vice-President and
General Manager
Toshiba America, Inc.
before the
SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS & MEANS
on
H.R. 2349

February 6, 1986

Mr. Chairman and Members of the Committee:

My name is Robert Traeger. I am Vice-President of Toshiba America, Inc. ("TAI") and General Manager of TAI's facility located near Nashville, Tennessee, where some 400 workers are employed in the assembly of televisions. We appreciate the opportunity to testify today about H.R. 2349.

We oppose H.R. 2349. The basic reason why we oppose it is that, from our standpoint, it would do nothing to encourage purchases of U.S.-made picture tubes, because we already purchase from U.S. suppliers all of our requirements for those picture tube types and sizes which are available here. What this bill would do is make it much more expensive for us to assemble in Tennessee those TV's requiring picture tubes not available in the U.S. -- so expensive, in fact, that sooner or later we would be forced to import those TV models instead of assembling them in Tennessee. Thus the result of this bill, as far as we are concerned, would be a net loss of jobs for U.S. workers.

Indeed, if we did not start to import some of those models, the bill would actually put us at a serious disadvantage in competing with the major U.S. companies who not only no longer make tubes here but who are increasingly importing finished TV's. The bill would penalize us for making TV's in America and reward the other U.S. companies who are moving jobs offshore. It doesn't make sense.

Let me explain our situation and the effects of this bill in more detail.

A. BACKGROUND

Most of our TV models assembled in Tennessee use picture tubes of a size and type available in the U.S. For all of these models, we purchase the tubes here, and import the chassis and customer control panel.

Some of our TV models assembled in Tennessee use picture tubes of a size and type not available to us in the U.S. For those models, we import the picture tube as well as the chassis, customer control panel and other components. In all cases, we purchase cabinets, speakers and other components in the U.S.

The tube, chassis and customer control panel constitute the basic operating portion of a TV. When entered together, they are currently dutiable as a TV receiver kit at a 5% rate under item 684.96 of the Tariff Schedules of the U.S. (TSUS). This item derives from item 685.20 of the original Tariff Schedules, covering "television apparatus."

A continuous, consistent line of U.S. Customs Service rulings, going back 14 years, has treated the basic operating portion of a receiver, including a picture tube, as an unfinished television receiver subject to the 5% rate. These Customs rulings are based on General Headnote 10(h) of the Tariff Schedules, which provides that a tariff description for an article covers that article whether finished or unfinished and whether assembled or unassembled. In addition, since 1979 TV receiver assemblies have been covered specifically under item 684.96 (formerly item 685.14).

This line of Customs authority has been recently reviewed in exhaustive detail and upheld again by Customs in a proceeding under section 516 of the Tariff Act. This latest decision is now on appeal to the Court of International Trade.

B. EFFECTS OF H.R. 2349

H.R. 2349 would triple the duty rate on picture tubes imported as part of TV receiver "kits" by making the tubes dutiable separately at a 15% rate under item 687.35, TSUS. This 300% duty increase is presumably aimed at helping the U.S. TV industry and its workers. It is undoubtedly a well-intentioned effort by its sponsors to do so. From our perspective, however, it would have precisely the opposite effect:

1. The bill will not increase purchases of U.S.-made picture tubes

The bill could not and would not induce TAI to purchase any additional U.S. picture tubes because we already purchase from U.S. suppliers all of our requirements for picture tubes which are available to us in the U.S. We purchase all the U.S. picture tubes we can because we have been able to obtain a better price for U.S.-made tubes, partly because of savings in freight and duty, and because U.S. purchasing reduces overall inventory levels and improves delivery time.

In 1985, our purchases of U.S.-made tubes accounted for 62% of our total picture tube purchases in terms of volume and 60% in terms of dollar value. These U.S.-made tubes include conventional round tubes in sizes 13", 19" and 25". We also purchase 20" square tubes not meeting Toshiba-brand specifications but which we use for contract production of other brands.

The picture tubes imported by TAI, as part of receiver assemblies, include conventional tubes in sizes under 13" and 15", and flat square tubes in 14", 20" and 26" sizes for Toshiba-brand models. Conventional tubes in sizes under 13" and 15" are currently unavailable from U.S. producers. Flat square tubes (FST's) with the specifications required by TAI for Toshiba-brand televisions are also unavailable in the U.S. in any screen size. These flat square tubes employ advanced, patented technology developed by Toshiba.

At this very time, we are moving to increase our use of U.S.-made tubes. Since the flat square tubes using Toshiba technology are not offered by any U.S. manufacturer, the only way to "source" them in the U.S. is to make them in the U.S. And TAI is going to do so. Toshiba itself, in a joint venture with Westinghouse, will commence the manufacture of 20" flat square tubes in the U.S., at a plant in Horseheads, New York. Ultimately this U.S. production will totally replace imports of this size picture tube.

Even after production commences at the Horsehead's facility, however, it will remain necessary for us to import conventional picture tubes in sizes under 13" and 15", and flat square tubes in sizes of 14" and 26", none of which are available here. Further, U.S. producers are gradually phasing out their U.S. production of 13" conventional tubes, which means that over time we will be required to import more of these tubes in receiver assemblies. (See TV Digest, February 3, 1986, pp. 9-10).

Thus, H.R. 2349 will not help U.S. tube makers. No amount of duty increase can induce companies to purchase tubes in the U.S. that are not made or sold in the U.S.

2. The bill threatens U.S. jobs

For the models of TV's for which picture tubes are not available in the U.S., we have only two choices: (1) import the tube, control panel and chassis kit and assemble the TV here, as we do now or (2) bring in finished TV's.

H.R. 2349 would increase the duty on the picture tubes included in receiver kits from 5% to 15%, but leave intact the 5% duty on finished TV's. Thus the bill would increase TAI's costs for those models by 10% of the value of the tubes included in the kits. Given the very price-competitive television market, this substantial increase would in all likelihood force us to import these models as finished TV's rather than assembling them here.

We have just opened a third assembly line for production of some of these models. The bill directly jeopardizes the future of this line and the jobs of the 100 employees who depend on it. Our existing production could well be cut back further, with more loss of jobs, if we cannot afford to import kits for models for which tubes are not available here, especially 13" sets for which U.S.-made tubes may be unavailable in the near future. In addition, the bill would deter growth in our U.S. TV assembly operation. There is room for three more lines at our facility. This bill will certainly discourage future expansion by making it too costly to assemble in Tennessee models for which we must import receiver kits including picture tubes.

Indeed, in the case of 13" sets, if the bill passed and we did not start to import finished sets, we would be competing at a disadvantage with major U.S. firms. Increasingly these firms are not only stopping U.S. production of 13" tubes, but are importing finished 13" sets. They are not making anything here. This bill would penalize us for making TV's in America while rewarding other U.S. firms, our competitors, for moving jobs offshore. And that doesn't make sense.

The threat to both existing production and future expansion at our plant would hurt not only our own workers, but the other firms in Tennessee and elsewhere in the U.S. from which we now obtain speakers, cabinets and other componentry accounting for 40% of the material costs for the models for which we import kits.

Insofar as it affects our company, then, H.R. 2349 would seriously threaten a loss of U.S. jobs without creating a single additional sale of any picture tube by any U.S. firm. The net impact of the bill will be less, not more, U.S. employment.

3. The bill would reverse a long-standing tariff treatment based on fundamental principles

H.R. 2349 would not clarify any open issue or close any "locphole." To the contrary, it would reverse a long-standing tariff treatment based on consistent application of fundamental classification principles.

As I noted earlier, a continuous line of Customs rulings -- going back 14 years and pre-dating any imports by TAI or other companies involved -- has treated components forming the basic operating portion of a TV, including the picture tube, as an unfinished, unassembled TV receiver to be dutied at the same rate as a finished TV receiver. These rulings are based on the fundamental principle, enacted by Congress as General Headnote 10(h), that unassembled parts sufficient to constitute an "unfinished" article are to be classified as the article itself.

The U.S. Trade Representative (USTR) created a specific statistical category for incomplete receiver kits in 1977, under the general category for TV receivers. The President made this a specific tariff category (685.14) in 1979 in order to implement certain tariff concessions made at the Tokyo Round of trade negotiations. However, neither USTR in 1977, nor the President in 1979, intended to change the existing treatment of unfinished TV assemblies including picture tubes. These assemblies were classifiable under item 685.20 at 5% well before 1979 and have remained classifiable under the successor to item 685.20 (item 685.14, now item 684.96) at 5% after 1979, based on General Headnote 10(h).

The principle of General Headnote 10(h) applies to all imported products unless the language of the Tariff Schedules indicates otherwise. Thus, in other situations where an "inverted" tariff exists (so that a component of a product is dutiable at a higher rate than the product itself), imports of the product in unassembled, unfinished form would be dutiable at the lower rate. There is no indication that Congress ever intended any different principle to apply with respect to picture tubes imported as part of an unfinished TV assembly. Thus, the bill would suddenly change established tariff practice and single out TV receiver assemblies for a different treatment.

4. Enactment of H.R. 2349 would violate GATT

The unilateral tariff increase to be imposed by H.R. 2349 would violate the GATT, which requires signatories to abide by the duty rates they agree to at trade negotiations. The current 5% rate was agreed to by the U.S. in the Kennedy Round trade negotiations.

By increasing this GATT-bound rate through a classification change, H.R. 2349 exposes the U.S. to sanctions by our trading partners, including compensation payments.

5. The bill would discourage further investment

In addition to forcing cutbacks at our TV assembly operation, the H.R. 2349 could well discourage further foreign investment in the U.S. generally. Foreign firms have made and expanded investments in U.S. production facilities in recent years. Our company, Toshiba America, has just announced that it will invest $37 million to establish a plant in Irvine, California to produce medical electronics and telecommunications products. Tariff structures are important in these decisions, to the extent components must be imported. For example, in the current expansion of our Tennessee TV assembly plant, we relied on the long-standing current tariff treatment of unfinished receiver assemblies including picture tubes.

H.R. 2349 would send a message to all potential foreign investors that tariff structures critical to their U.S. operations are subject to sudden drastic changes that directly contradict both established Customs policy and the GATT obligations of the United States. This message can only serve to discourage foreign firms from investing in U.S. production facilities which create jobs for U.S. workers.

5. The bill undermines U.S. trade policy goals

Finally, this bill would overturn settled expectations of U.S. trading partners based on years of administrative precedent, and circumvent the administrative and judicial process for interpreting tariff items. This would surely be perceived by our trading partners as "bending the rules" of fair trade, even if it were not also a clear violation of their rights under negotiated agreements.

We submit that the United States cannot afford to undermine its own credibility in this way at the very time when it seeks to enforce its own rights under agreements with Japan and other countries, and to open foreign markets to U.S. goods in the name of free trade.

Mr. Chairman, in sum, we respectfully suggest that H.R. 2349 will not help the picture tube industry but will hurt our company and its workers. It will discourage further creation of jobs here and will undermine our trade policy. We urge that H.R. 2349 not be enacted.

H.R. 2354

To amend the Tariff Schedules of the United States with respect to motor fuel, motor fuel blending stock, and naphthas, and for other purposes.

See also American Petroleum Institute at H.R. 1566.

STATEMENT OF AMERADA HESS CORPORATION

Summary

H.R. 2849, a bill designed to control imports of gasoline and motor fuel blending stock from foreign countries, inequitably taxes Hess gasoline produced on St. Croix, U.S. Virgin Islands, an American insular possession. The total production of dutiable Hess gasoline at its St. Croix refinery would be subject to the rate structure proposed by the bill. Enactment of H.R. 2849 in its present form would result in a minimum estimated duty increase of 400% on Hess gasoline, an unconscionable and surely unintended result.

Hess proposes that H.R. 2849 be amended to exempt from items 475.21 through 475.24 gasoline and motor fuel blending stock that are products of U.S. possessions and trust territories, rendering such products dutiable under item 475.26 at the current rate of 1.25 cents per gallon.

H.R. 2354, introduced for the same purposes as H.R. 2849, is even more draconian in its effect upon Hess. The rate structure, though less complex than that of H.R. 2849, would nevertheless trigger minimum estimated duty increases of 800% on Hess gasoline and 700% on Hess jet fuels, a clearly inequitable result.

Hess proposes that H.R. 2354 be amended to exempt from items 475.26, 475.27, and 475.29, gasoline, motor fuel blending stock, and other finished petroleum products that are manufactures of U.S. possessions and trust territories. Such products should remain dutiable at the current rate of 1.25 cents per gallon.

INTRODUCTION

On January 24, 1986, the Subcommittee on Trade of the House Committee on Ways and Means issued press release #15 requesting written statements for the record from interested parties concerning a variety of tariff and trade bills. On behalf of Amerada Hess Corporation, 1185 Avenue of the Americas, New York, NY 10036, we submit the following comments on, and proposed amendments to, H.R. 2849 and H.R. 2354.

Amerada Hess Corporation (hereinafter, Hess) produces and markets gasoline, distillate, jet fuel, residual fuel oils, and other products derived from crude petroleum. Virtually all of these products are produced at the company's refinery on St. Croix, U.S. Virgin Islands, and are shipped directly to the U.S. mainland. Hess uses both foreign crude and Alaskan North Slope crude in its Virgin Islands refining process.

Amerada Hess Corporation occupies a unique position among domestic oil companies in that it is an American corporation with its predominating refining facilities located in a United States possession, viz., St. Croix, Virgin Islands.[1] Although a possession of the United States, the U.S. Virgin Islands are by statute outside the customs territory of the United States. Products of the Virgin Islands are therefore dutiable upon importation into the continental U.S. As a result of these unique circumstances Hess, in contradistinction to its domestic brethren, must pay duty on approximately 70% of its finished refinery products (30% enter the U.S. duty-free, pursuant to General Headnote 3(a) of the Tariff Schedules as that provision applies to products made with Alaskan North Slope crude.) Accordingly, H.R. 2849 and H.R. 2354 will have an enormously deleterious impact upon Hess gasoline and other motor fuel products — an impact not shared by other domestic producers/refiners.

H.R. 2849

H.R. 2849, "a bill to increase the rates of duty on gasoline and motor fuel blending stock, and for other purposes," was introduced by Representative Donald Young of Alaska on June 24, 1985 and was referred to the Committees on Ways and Means, Public Works and Transportation, and Energy and Commerce. The bill eliminates item number 475.25 of the Tariff Schedules of the United States (TSUS), which currently provides for "motor fuel," and creates five new provisions (items 475.21, 475.22, 475.23, 475.24, and 475.26). Items 475.21 through 475.24 inclusive provide only for imported gasoline and "motor fuel blending stock" (defined by a new subdivision (c) to Headnote 2 of Part 10, Schedule 4, as added by the bill); item 475.26 covers motor fuels other than gasoline, e.g., naphtha-type and kerosene-type jet fuels. The rate of duty applied to products imported under item 475.26 is 1.25 cents per gallon, the rate currently in effect for all motor fuels imported under item 475.25. Hess produces jet fuel at its St. Croix refinery that would be imported under item 475.26.

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[1] Measured by refining capacity, the Hess refinery on St. Croix, with a capacity of 650,000 barrels per day, is the largest in the world.

Items 475.21 through 475.24, as added by H.R. 2849, provide only for imported gasoline (and blending stock); the provisions differ only as to the rate of duty and the circumstances of its application. The bill charges the International Trade Commission with responsibility for estimating total imports of Schedule 4, Part 10 products (with certain exceptions not pertinent to this discussion) for a 12-month period and for determining therefrom three discrete "gallonage allotments" for purposes of applying four rates of duty to imported gasoline (1.6%, 6.5%, 11.4%, and 16.4% ad valorem for items 475.21 through 475.24, respectively). The bill requires that the first gallonage allotment (item 475.21) consist of 1.65% of the ITC estimate; the second gallonage allotment (item 475.22) consist of 3.7% of the estimate; and the third gallonage allotment (item 475.23) consist of 5.7% of the estimate. Item 475.24 would cover all imported gasoline in excess of the aggregate gallonage allotments during the 12-month period.

Oil companies with refining facilities on the mainland United States may now be importing 10 to 20 percent of their finished products, i.e., gasoline and other motor fuels and motor fuel blending stock. As the gallonage allotments created by H.R. 2849 increase the duty rate on imported gasoline, these companies will be able to import product subject to the first gallonage allotment (an advantageous rate of 1.6% ad valorem) and shift to greater domestic production (and concomitantly less imported product) as the second and third allotment rates take effect.

Hess has no such option. All of its gasoline production is dutiable (with the exception of its Headnote 3(a) merchandise) and is thus susceptible to the three allotment rates applicable in items 475.21-.23 and the extraordinarily high residual rate (16.4% ad valorem) to be applied under item 475.24. In calendar year 1984, Hess imported 529.2 million gallons of gasoline subject to duty under current item 475.25. At the applicable rate of 1.25 cents per gallon, Hess paid actual duties of $6,615,000. Had the formula and rate structure proposed in H.R. 2849 been in effect in 1984, Hess's duty liability would have been vastly different. **Based upon import statistics obtained from the Department of Commerce, calculating gallonage allotments in accordance with the ITC formula outlined in the bill, and assuming an average customs value of $32.00 per barrel (or 76 cents per gallon), Hess's duty liability in 1984 would have amounted to $24,576,500 under H.R. 2849 — an enormous 372% increase over its actual 1984 duty liability.** Using Department of Commerce statistics for January through June, 1985 and extrapolating to obtain an annual projection, we estimate that in 1985 Hess would have been liable for $29,562,000 in duties under the H.R. 2849 formulation; its duty liability under the current rate was $7,276,000. **The net effect of the proposed legislation would have been to increase Hess's 1985 duty liability by an unconscionable 406%.** (We note here that if one uses the actual allotments prescribed in H.R. 2849 for the period July, 1985 through June, 1986, rather than the ITC formula proposed for all succeeding periods, Hess's 1985-86 liability would be $39,859,000 — a 547% increase!) Unlike its domestic brethren, Hess cannot avoid the severe impact of the second and third allotment rates, and the 16.4% rate which succeeds them, by halting its import program after the first gallonage allotment has been exhausted. The result of the proposed legislation as presently formulated is as inequitable as it is, assuredly, unintended.

Hess does not seek to avoid payment of duty on gasoline products that are not eligible for Headnote 3(a) treatment. The company's status as a refiner located in a U.S. possession rather than on the mainland should not, however, result in placing Hess at an enormous disadvantage to other domestic oil companies. Accordingly, Hess proposes that should the basic framework of H.R. 2849 meet generally with the subcommittee's approval, the bill be amended to exempt gasoline and motor fuel blending stock produced in United States insular possessions or trust territories from the four-tiered rate structure provided in items 475.21 through 475.24. The exemption would be effected by inserting a parenthetical in the superior heading to item 475.21 as follows:

> Gasoline and motor fuel blending stock (except products of
> United States insular possessions and trust territories) entered
> during an annual period:

The parenthetical would result in the classification of gasoline and motor fuel blending stock from U.S. insular possessions and trust territories under the basket provision, item 475.26, TSUS, at the current duty rate of 1.25 cents per gallon.

H.R. 2354

As in the case of H.R. 2849, oil companies with refining facilities on the mainland United States that are now importing only a fraction of their finished gasoline and motor fuel products will be able to shift to greater domestic production in order to avoid the draconian duty rate increases imposed by H.R. 2354. Hess is unable to do so.

With the exception of Headnote 3(a) merchandise manufactured with Alaskan North Slope crude, Hess's gasoline and other motor fuel production is dutiable and therefore susceptible to the two-tiered rate structure set out in H.R. 2354. As previously indicated, in calendar year 1984 Hess imported 529.2 million gallons of gasoline subject to duty under current tariff item 475.25. These imports resulted in duties of $6,615,000. Had the two-tiered rate structure imposed by H.R. 2354 been in effect during this period, the result would have been even more devastating than that compelled by H.R. 2849 and discussed above on pages 3-5. Based upon import statistics obtained from the Department of Commerce, the 3-billion-gallon ceiling on gasoline and motor fuel blending stock created by H.R. 2354 would have been reached in late September, 1984. Accordingly, Hess would have been subject to a duty rate of 10.8% ad valorem for the first nine months of 1984 and 21.6% ad valorem for the final three months. **Assuming an average customs value of $32.00 per barrel (or 76 cents per gallon), Hess's duty liability in 1984 would have amounted to $56,136,000 under H.R. 2354 — an unconscionable 849% increase over its actual 1984 duty liability.** Extrapolating the Department of Commerce statistics for 1985, we estimate that in 1985 Hess would have been liable for $66,355,000 in duties under the H.R. 2354 rate structure; its duty liability under the current rate was $7,276,000. **The net effect of Representative Anthony's proposed legislation would have been to increase Hess's 1985 duty liability by an enormous 912%.**

H.R. 2354 would have a similar devastating impact upon Hess's imports of jet fuels (products unaffected by H.R. 2849). Assuming an average customs value of $35.00 per barrel (or 83 cents per gallon), **Hess's duty liability, as a result of a rate increase from 1.25 cents per gallon to 10.8% ad valorem, would increase 720%.**

Unlike oil companies with refining facilities located on the mainland United States, Hess cannot avoid the severe impact of such enormous duty increases. As in the case of H.R. 2849, the result of the legislation proposed in H.R 2354 — as presently formulated — is inequitable and, we believe, unintended.

Hess therefore proposes that, should the subcommittee favor the basic thrust of H.R. 2354, the bill be amended to exempt gasoline and other motor fuels produced in United States insular possessions or trust territories from the exorbitant rates proposed for items 475.26, 475.27, and 475.29. Hess proposes that these products of U.S. possessions and territories be separately provided for at the current duty rate of 1.25 cents per gallon.

CONCLUSION

Hess is prepared to submit such information to the subcommittee as it deems advisable or necessary in determining the appropriate rate structure to be effected by either H.R. 2849 or H.R. 2354. Hess requests that the subcommittee take appropriate steps to correct the obviously unintended inequity of the bills in their present form.

Respectfully submitted,

DONOHUE AND DONOHUE
Attorneys for
Amerada Hess Corporation

EXXON COMPANY, U.S.A.
STATEMENT ON PETROLEUM PRODUCT IMPORTS

FEBRUARY 1986

Exxon appreciates the opportunity to offer its comments to the House Ways and Means Trade Subcommittee regarding the need for added protection for U.S. refiners from petroleum product imports.

We do not see at this time justification for additional tariffs and/or the imposition of quotas or other quantitative restrictions on U.S. petroleum product imports. Overall, we find few tariff barriers prohibiting imports of petroleum products into other major consuming countries. Current levels of U.S. refining capacity do not lend support to arguments that there is a near-term threat to national security.

However, recognizing that circumstances could change, we believe it is appropriate to continue to monitor the product import situation closely. If unfair trade practices are shown to exist at some time in the future, existing U.S. statutes already provide adequate authority for the U.S. government to take offsetting protective measures. No new protective legislation is necessary. We do, however, support adjustments to the existing tariff schedules to remove uneven treatment of motor gasoline blendstocks.

U.S. Product Imports

As shown in Table I below, current U.S. net product import levels are not high by historical standards. In 1973, net imports represented about 16 percent of demand. This declined to a low of about 7 percent in 1982, and currently accounts for about 9 percent.

Since 1973, there has been a change in the product import mix. In 1973, most product imports were distillates and heavy fuel oil. Today, motor gasoline and gasoline blendstocks represent a more significant share, while distillate imports have declined. Fuel oil imports also have declined, reflecting reduced fuel oil demand for electricity generation and industrial boiler fuel.

TABLE I
NET U.S. PETROLEUM PRODUCT IMPORTS - MILLION B/D

	1973	1982	1984
Motor Gasoline/Blendstocks	0.2	0.2	0.4
Middle Distillates	0.7	0.1	0.3
Fuel Oil	1.8	0.6	0.5
Total Products	2.8	1.1	1.4
% of Demand	16	7	9

Exxon's petroleum product imports as a percent of supply are not significant. In 1984, total net imports were about 6 percent, with negligible imports of finished clean products such as motor gasoline and distillates.

In recent congressional testimony, petroleum product import data on both a gross and net basis have been used. Currently, the U.S. exports about 500 thousand B/D of petroleum products, mostly distillate, heavy fuel oil, and petroleum coke. Most of these exports could be readily converted to domestic use. As a result, we believe net product imports are a more meaningful measure.

Sources of Product Imports

Proponents of import protection tend to link the recent increase in motor gasoline/gasoline blendstock imports and distillate imports with the new Middle Eastern and African refining capacity. Contrary to the concerns being expressed, most of this increase has come from Latin America, not from the Middle Eastern and African (MEAF) refineries.

TABLE II
NET U.S. PETROLEUM PRODUCT IMPORTS - THOUSAND B/D

	Gasoline/Blendstocks		Distillates	
	1982	1984	1982	1984
Latin America	3	106	2	86
Caribbean	81	82	93	111
China/Romania	33	54	-	-
Europe	31	42	(18)	30
Canada	20	17	10	14
MEAF	12	15	-	25
Total	220	370	55	280
% of Demand	3	5	2	7

Net imports of motor gasoline/blendstocks have increased since 1982 from 220 thousand B/D, representing 3 percent of demand, to 370 thousand B/D, or 5 percent of demand in 1984. The U.S. imports motor gasoline from over 20 countries. During 1984, 106 thousand B/D, or nearly 30 percent of the total, came from Latin American sources, principally Venezuela, Brazil, and Mexico. Another 82 thousand B/D, or more than 20 percent, came from refineries owned by U.S. companies located in the Caribbean. Although not major suppliers of the total range of products, China and Romania supplied another 15 percent. MEAF refineries accounted for 15 thousand B/D, or only about 4 percent of the total.

Net distillate imports increased from 55 thousand B/D, representing 2 percent of demand in 1982, to 280 thousand B/D, or 7 percent of demand in 1984. Like motor gasoline, they originate from a variety of sources. The 1982 levels were at an all time low because of warm weather in the U.S. In 1984, on the other hand, distillate imports were required to supplement short U.S. supplies when unusually harsh winter weather early in the year increased demand and significantly curtailed U.S. refinery operations. During 1984, almost 200 thousand B/D, or nearly 70 percent of the total, came from Latin American and Caribbean sources. There were no net imports from MEAF refineries in 1982, and only about 25 thousand B/D during 1984.

Restrictions in Other Importing Countries

We do not believe that the current international tariff structures represent barriers of sufficient significance to justify raising U.S. tariffs. There are few restrictions to regional international flows of petroleum products. The exceptions are typically for a specific product to individual countries; such as finished motor gasoline to Japan and France.

Both Europe and Japan have higher import duties than the U.S. However, the European Community has been waiving the duties from most countries except the U.S., Canada, and most Soviet bloc sources. While the Japanese duty on gasoline appears high relative to that in the U.S., the differential between crude and gasoline tariffs is about the same. Although the Japanese government does not formally prohibit motor gasoline imports, informal suasion has kept imports out. Recently, Japan's Ministry of International Trade and Industry (MITI) has expressed a willingness to allow limited motor gasoline imports. A small amount is expected to occur in 1986. The low Japanese tariff on naphtha relative to crude has resulted in significant imports of naphtha for petrochemical feedstocks.

In 1984, Japan's net product imports accounted for 15 percent of its total petroleum demand, compared with only about 9 percent for the U.S. In Europe, based on data available for three quarters of 1984, net product imports accounted for 11 percent of total product demand.

National Security Implications

Some have expressed concern that further U.S. refining capacity rationalization could threaten national security. The question of national security may be relevant at some future time, but the current level of U.S. refining capacity and its utilization suggests that it is not an issue at present. Even though capacity has declined by almost 2.5 million B/D from peak levels in 1981, the first year of U.S. price and allocation decontrol, there is still a large surplus. During 1984, U.S. average operable capacity was about 16 million B/D, well above crude run levels in the 12 million B/D range. Average operable refining capacity utilization in 1984 was only 75%.

TABLE III
U.S. REFINING CAPACITY/UTILIZATION

	1981	1984
Avg. Capacity, Million B/D		
Operable	18.3	16.0
Operating	17.1	14.6
Avg. Utilization, %		
Operable	68	75
Operating	73	83

The current refining capacity is well above the level needed to run the combined total of U.S. domestic crude production (8.8 million B/D) and current maximum SPR drawdown (2.3 million B/D) of 11.1 million B/D. Even with further U.S. refining capacity rationalization, there will likely be adequate capacity to run domestic crude production plus the planned maximum SPR drawdown of 4.5 million B/D. Additionally, spare refining capacity in countries tributary to the U.S., such as the Caribbean, as well as in Europe, would provide possible sources of additional product if needed in an emergency.

Legal Remedies

Should circumstances at any time indicate unfair trade practices by foreign country governments or a legitimate threat to U.S. national security, adequate remedial authorities already are available to the President and Congress.

The General Agreement on Tariffs and Trade (GATT) establishes internationally-accepted remedies to protect against unfair trade practices. These principles are incorporated into existing U.S. trade statutes which provide protection against dumping and foreign export subsidies. Imports can be restricted to protect U.S. industries from "serious injury," or the threat of "serious injury" if imports are the cause. Also, imports can be restrained as necessary if national security is threatened. As a result, no new legislation is needed for this purpose.

Disadvantages of Trade Restrictions

Trade restrictions would damage the U.S. economy through increased consumer petroleum prices, higher inflation, lower real GNP, and higher unemployment. Increased product prices would place U.S. industries at a competitive disadvantage in international markets.

Further, trade restrictions could invite reciprocal foreign reaction. The probable outcome is that everyone would lose -- the volume of world trade would decline, leading to even greater losses in economic efficiency and welfare. Resulting lower foreign GNP would affect debt repayment ability.

Technical Corrections to Existing Tariff Schedules

A separate but related issue concerns the tariff treatment of motor gasoline blendstocks. Current anomalies in the schedule allow some motor gasoline blendstocks to enter with a duty of 0.25¢/gallon, while finished gasoline enters at 1.25¢/gallon. We believe the addition of a motor fuel blendstock category in the tariff schedule, with the same duty as motor fuel, is an appropriate means of correcting this anomaly.

Summary

Exxon does not at this time see a justification for additional tariffs and/or the imposition of quotas or other quantitative restrictions on the importation of petroleum products into the U.S. We suggest continued monitoring of the product import situation to assure that a national security threat does not develop at some time in the future, and to guard against unfair trade practices by foreign country governments. Also, we support adjustments to existing tariff schedules to remove uneven treatment of mogas blendstocks.

In general, Exxon supports free trade as being the most efficient means of promoting a competitive, economically viable domestic refining industry. Inappropriate or premature use of protective tariffs or quotas to restrict petroleum product imports may invite reciprocal foreign reaction. In addition, protective tariffs or quotas would harm the U.S. economy by increasing consumer prices, increasing inflation, and reducing real GNP.

H.R. 2396

To change the tariff treatment with respect to naphtha and motor fuel blending stocks.

See also American Petroleum Institute at H.R. 1566, and Exxon Co., U.S.A. at H.R. 2354.

THE HONORABLE ROBERT T. MATSUI

TESTIMONY ON H.R. 2396

I appreciate the opportunity to present testimony in support of my bill, H.R. 2396. This legislation is similar to legislation which I sponsored in the 98th Congress, H.R. 5754, which was favorably reported by the Trade Subcommittee and the Ways and Means Committee. I hope that the Subcommittee will again demonstrate its wisdom on this important issue.

The purpose of my bill is to bring reason and certainty to the gasoline marketing segment of the oil industry. The current tariff treatment of motor fuel blendstocks at rates substantially higher than the tariff on gasoline actually discourages the manufacture of gasoline in the United States, which is clearly an anomaly in our tariff structure. My bill simply eliminates this inverted tariff structure. The bill creates a new tariff classification for gasoline components and subjects these components, on an actual use basis, to the same tariff as is now imposed on the importation of finished gasoline.

When this legislation was considered in conference in the last Congress, it was decided that the issue should be studied further, and the International Trade Commission was directed to conduct an investigation. The study, which has been completed and released to the Congress, is supportive of the intent of H.R. 2396.

I addition, I have contacted the Federal Trade Commission to explore the effect of this legislation on competition in the marketplace. The Commission responded by stating that legislation that places "import restrictions such as tariffs do not simply favor some firms over others, but may adversely affect competition in the market as a whole". H.R. 2396, on the other hand, encourages competition in the market.

This bill will also bring certainty to the marketplace for marketers of gasoline, especially independent marketers of gasoline, and it will benefit consumers with the lowest possible energy prices.

We have heard a great deal this year about budget deficits, and ways of raising revenues. An oil import fee is frequently mentioned as a means of raising revenue in order to meet the restrictions imposed by the Gramm-Rudman-Hollings legislation. But my bill is not a revenue issue, it is a trade issue and it is both good trade policy and good energy policy.

H.R. 2396 is a positive step toward reducing our trade deficit. If the United States can manufacture and transport U.S. goods with low energy costs, our products will be more competitive in the international marketplace. If, on the other hand, we increase energy prices, it will only serve to exacerbate the trade deficit further.

The vast majority of imports of motor fuels and blendstocks into the United States are supplied by friendly U.S. trading partners. We on the Ways and Means Committee have a responsibility to our allies and trading partners such as Canada, Mexico, Venezuela, and China who are substantial suppliers of product imports. H.R. 2396 is responsible trade policy.

Independent refiners have opposed this legislation. In fact, they have tried to put up trade barriers wherever they thought they could make a case. They have tried to claim that imports or motor fuels and blendstocks threaten our national security. But in a December hearing in the Armed Services Committee, the only witness that supported them was a consultant they had hired. The Department of Energy, the Department of Defense, and the Department of Commerce all steadfastly maintained that our national security is not threatened. In fact, one could contend that our national security is enhanced by maintaining good trade relations with our neighbors to the north, Canada, and the south, Mexico, the Caribbean, and Venezuela.

The refiners have used a protectionist argument, claiming dramatic import penetration. Single digit import penetration, often at below five percent, is a number most American industries cannot even hope for. They have not convinced me, and I hope they will not convince you.

I urge my colleagues to support H.R. 2396. It will encourage manufacturing, it will improve competition, and it is good trade policy.

Thank you, Mr. Chairman

H.R. 2849

To increase the rates of duty on gasoline and motor fuel stock, and for other purposes.

See Amerada Hess Corp., and Exxon Co., U.S.A. at H.R. 2354. No other statements received.

H.R. 2885

To implement the Nairobi Protocol to the Florence Agreement on the Importation of Educational, Scientific, and Cultural Materials, and for other purposes.

AMERICAN FOUNDATION FOR THE BLIND, INC.
GOVERNMENTAL RELATIONS DEPARTMENT
1660 L STREET, N.W.
SUITE 214
WASHINGTON, D.C. 20036
TEL: [illegible]

RECEIVED
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Ways and Means
Subcommittee on Trade

February 4, 1986

The Hon. Sam Gibbons
Chairman, Subcommittee on Trade
Ways and Means Committee
1136 Longworth H.O.B.
U.S. House of Representatives
Washington, D.C. 20515

Re: H.R.2885, to implement the Nairobi Protocol.

Dear Mr. Chairman:

With the understanding that your committee will include H.R.2885 as one of the trade bills to be considered at hearings on February 6, the American Foundation for the Blind would like to express our strong support of permanent authority for duty-free treatment of articles for the blind and other handicapped.

As your committee's records will show, the American Foundation for the Blind has also registered support for predecessor legislation, and as a member organization of the World Union for the Blind, has encouraged reciprocity by other countries. We have been informed that EEC member countries last month have indicated a willingness to support provisions for the blind. As you know, U.S. treatment of these articles has technically been suspended since August 15, 1985, and we would be deeply appreciative of your efforts to expedite this legislation.

Please accept our thanks for your committee's consideration of H.R.2885 at the February 6 hearings, with our request that this statement will be included in the record of hearings.

Sincerely,

Barbara D. McGarry

Barbara D. McGarry

BM/am

cc: Mr. William F. Gallagher

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AMERICAN LIBRARY ASSOCIATION
WASHINGTON OFFICE
BOX 54 110 MARYLAND AVENUE, N.E. WASHINGTON, D.C. 20002
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EXECUTIVE
OFFICES:
50 EAST HURON ST.
CHICAGO, ILL. 60611

STATEMENT OF THE AMERICAN LIBRARY ASSOCIATION

to the Subcommittee on Trade

House Ways and Means Committee

in support of H.R. 2885

A bill to implement the Nairobi Protocol to the Florence Agreement on the Importation of Educational, Scientific, and Cultural Materials

February 6, 1986

The American Library Association, a nonprofit educational organization of 42,000 librarians, library trustees, and friends of libraries dedicated to the improvement of library services, strongly recommends early and favorable action on HR 2885 with one proposed amendment.

ALA has been for some thirty years an active supporter of the original Agreement and the many improvements in the Protocol such as the provisions relating to the handicapped. We regard the Agreement, now in force in some 90 countries, as an outstanding example of practical, effective and successful international cooperation in the fields of science, education and culture, providing substantial benefits in all countries in which it is in force.

We are disappointed, however, that HR 2885 takes a step backward from the temporary legislation which has been in effect for the last thirty months and has provided unrestricted duty-free entry to audio, visual and microform materials pursuant to Annex C-1 of the Protocol.

The present bill, implementing Annex C-2 of the Protocol is no substantial improvement, restricting as it does duty-free entry to these materials only if they are (1) certified by a federal agency as educational, scientific, or cultural in character, or (2) imported by or for the use of public or private institutions or associations and certified by the importer as educational, scientific or cultural in character. There is no justification for this discrimination against the newer media of communication, which serve the same purposes as the older printed media which are absolutely duty free under the original Agreement.

Libraries and educational institutions are not in the business of importing, but buy both their domestically produced and foreign audio, visual and microform materials from U.S. dealers who maintain stock. The certification process would cost more in paperwork than the saving in duty.

This brings us to the purpose of the remaining U.S. duties on these materials which would be applicable if the certification process is not used. These duties are already so low, and will be lower still in 1987, the final year of the "Tokyo Round" of trade agreements, that they provide no protection to American producers (who incidentally have not asked for protection), but merely add substantial paperwork costs both for government agencies and importers.

We urge therefore that the provisions of the expiring Educational, Scientific and Cultural Materials Act of 1982 with respect to audio, visual and microform materials be substituted for the provisions of section 103 of HR 2885, with power given to the President to apply more restrictive provisions if damage to U.S. industry can be demonstrated under Title II.

Attached to our comments is a Resolution on the Educational, Scientific and Cultural Materials Importation Act of 1985, passed by the ALA Council on July 10, 1985. Also attached is a resolution on the Nairobi Protocol to the Florence Agreement passed by the International Federation of Library Associations and Institutions (IFLA) on August 23, 1985.

Resolution on the Educational, Scientific and Cultural Materials Importation Act of 1985

WHEREAS, Senator Robert Dole of Kansas and Representative Sam Gibbons of Florida have introduced an Administration bill (S. 1274 and HR 2885) to implement the Nairobi Protocol to the Florence Agreement (text in June 11, 1985, Congressional Record, pp. S7934-6); and

WHEREAS, The Administration bill would be permanent legislation, replacing the temporary legislation of a similar nature, PL 97-446, which expires August 12, 1985, and would permit the United States to deposit the Protocol with the United Nations, the necessary approval of the Senate having already been secured; and

WHEREAS, The original Florence Agreement (Agreement on the Importation of Educational, Scientific and Cultural Materials), now in force as an international treaty in some 90 countries, has provided great benefits to libraries and their users, educational institutions, the general public and business organizations in the United States and throughout the world by eliminating import duties and certain other trade barriers on books, periodicals, printed music, scientific apparatus and other materials; and

WHEREAS, The Nairobi Protocol, now in force in some 13 countries, makes further improvements in the Agreement by granting duty free status to additional materials; and

WHEREAS, The existing temporary legislation is in one important respect superior to S. 1274 and HR 2885 in that it provides unconditional duty free importation into the United States of audio, visual and microform materials rather than restricting such duty free status to such materials formally designated as educational, scientific or cultural in character or imported by designated institutions; and

WHEREAS, The American Library Association and many other U.S. organizations representing both producers and consumers alike have supported the more liberal treatment of audio, visual and microform materials; and

WHEREAS, There has been no demonstration of adverse economic effect under the expiring temporary legislation nor, to our knowledge, complaints to this effect registered; now, therefore, be it

RESOLVED, That the American Library Association expresses its great appreciation to Senator Dole and Representative Gibbons for the introduction of S. 1274 and HR 2885 and to the Administration for its support; and, be it

FURTHER RESOLVED, That the American Library Association endorse S. 1274 and HR 2885 and urge prompt enactment, with one major modification, namely, that unconditional duty free treatment be accorded to audio, visual and microform materials, as provided in the expiring temporary legislation, but that the President be given discretionary power to revert to the more restrictive provisions of S. 1274 and HR 2885 if it can be demonstrated that on balance the more liberal provisions are causing significant hardship to American industry; and, be it

FURTHER RESOLVED, That copies of this resolution be sent to Senator Dole and Representative Gibbons, to Chairs of the Senate Committee on Finance and the House Committee on Ways and Means, the Secretaries of State and Commerce, the U.S. Trade Representative, the U.S. organizations which have supported the Nairobi Protocol and its more liberal provisions relating to audio, visual and microform materials, the International Federation of Library Associations and Institutions, and the International Publishers Association.

Adopted by the Council of the
American Library Association
Chicago, Illinois
July 10, 1985
(Council Document #47.8)

General Resolutions Presented to the IFLA Council 1985

Nairobi Protocol to the Florence Agreement, approved by the General Conference of UNESCO, November 30, 1976

WHEREAS the Florence Agreement (Agreement on the Importation of Educational, Scientific and Cultural Materials) by eliminating import duties on books, periodicals, printed music and other educational, scientific and cultural materials in over 70 adhering countries has provided great benefits to libraries and their users, as well as to educational institutions and the general public; and

WHEREAS a 1976 Nairobi Protocol (supplement) to the Protocol have adopted optional Annex C-2 which severely limits the duty free import of audio, visual and microform materials rather than optional Annex C-1, which extends duty free status to these materials on the same basis as books and other publications; and

WHEREAS the International Federation of Library Associations and Institutions, the International Publishers Association, the International Federation of the Phonographic Industry, and other international associations have long supported the Protocol and optional Annex C-1,

NOW THEREFORE BE IT RESOLVED that the International Federation of Library Associations and Institutions again urge its component national associations to recommend strongly to their national governments prompt adherence to the Protocol and optional Annex C-1; and

BE IT FURTHER RESOLVED that copies of this resolution be printed in the IFLA Journal and be sent to member associations of IFLA, to the Secretary-General of UNESCO, to UNESCO national committees in all countries adhering to the Florence Agreement and to the International Publishers Association, the International Federation of the Phonographic Industry and other international associations concerned.

Submitted by,

United States Member Associations
The American Association of Law Libraries
The American Library Association
The Art Libraries Society of North America
The Association for Library and Information Science Education
The Association of Research Libraries
The Medical Library Association
Special Libraries Association

Approved at the 1985 Conference of the
International Federation of Library
Associations and Institutions (IFLA)
Chicago, Illinois
August 23, 1985

ON BEHALF OF THE RECORDINGS IMPORT TRADE COMMITTEE IN SUPPORT OF H.R. 2885

February 13, 1986

The Recordings Import Trade Committee, (RITC) (membership list attached at A) strongly supports the passage of H.R. 2885, a bill to implement the Nairobi Protocol to the Florence Agreement on the Importation of Educational, Scientific, and Cultural Materials. RITC filed an initial statement to that effect on August 30, 1985. At the invitation of this subcommittee we have prepared this additional statement and request that it be filed as a part of the record.

The purpose of the Florence Agreement, which entered into force for the United States on November 2, 1966, is to facilitate the international flow of cultural materials (including books, publications, documents, works of art, collector's pieces, visual and auditory materials, scientific instruments and apparatus, and articles for the blind) through the extension of duty-free treatment. The purpose of the Nairobi Protocol is to broaden the list of products eligible for such treatment, including articles for the use of the blind and other handicapped persons.

The President, on January 16, 1981, submitted the Nairobi Protocol to the Senate for advice and consent. On January 12, 1983, the Educational, Scientific and Cultural Materials Importation Act of 1982 ("the 1982 Act") (Pub. L. 97-446; 96 Stat. 2346) was enacted directing (in Section 167(b)(1)) the President to proclaim temporary duty-free treatment for certain imported articles which would be covered by the Nairobi Protocol and authorizing the proclamation of duty-free treatment for other such items, if the President found it to be in the interest of the United States. The President found it to be in the interest of the United States and issued a Proclamation (#5021 of February 14, 1983) which instituted said duty-free treatment until August 11, 1985. Since that date liquidations have been suspended in view of the pendency of legislation which is expected to have retroactive application.

H.R. 2885, and its companion bill, S. 1274, were introduced in this Congress to authorize the President to deposit an instrument of ratification for the Nairobi Protocol, including Annex C-2, and if he finds it in the interest of the United States, to extend duty-free treatment to Annex C-1 items, subject to certain conditions.

H.R. 2885, would provide for the ratification of the Nairobi Protocol, which the United States signed in 1979, and for which the advice and consent of the Senate was received in October 1982. The Department of Commerce has stated to the Committee "it is the view of the Administration that ratification of the Protocol is in the national interest" (page 1, fourth paragraph). This was reaffirmed by Mr. Louis J. Murphy, Acting Director, Office of Industry Assessment of the Department of Commerce on February 10, 1986, before the Committee.

The overwhelming weight of the comments received is that H.R. 2885 should be passed to enable ratification to take place. The one industry which raised concern, hearing aids, is already in the process of availing itself of administrative remedies. As noted in the submissions by the Association of Research Libraries, the American Library Association and the Department of Commerce, the legislation provides both a mechanism and ample opportunity for redress for any industry adversly affected by the passage of this legislation and any resulting implementation of duty-free treatment.

On the other hand, the visually and otherwise handicapped, our libraries, and our school children have been long enough without the benefits of a protocol which was signed almost seven years ago.

It should be noted that further delays in action on the bill would be unfortunate, and it is suggested that H.R. 2885 should be given expedited treatment that would be unlikely if it were incorporated in an omnibus tariff bill. Entries of articles which could be covered by the legislation if enacted have had their liquidation temporarily suspended. Without knowledge of what duty rate will apply, pricing in these markets is uncertain, at best, and therefore discouraging.

The purposes of both the Florence Agreement and the Nairobi Protocol are clearly to aid the unfettered dissemination of the materials covered. Quick passage of this legislation would demonstrate our national commitment and send a message to other signatories of the Protocol, particularly the European Communities ("EC") member states, that implementation should take place quickly.

Timing is also important because the EC has definite procedural rules under which the next opportunity for tariff reductions in the EC is July 1, 1986 (with a six-week period necessary before that date to accomplish administrative matters). EC sources give reliable indications that EC member states would institute their tariff changes by July 1, 1986, if H.R. 2885 becomes law by May 1, 1986. Thus, passage of this measure would not only bring more timely benefits to our handicapped and other consumers, but also would signal the EC to act so that there would be reciprocal duty-suspensions in place in the countries which form the majority of the market for the industries which support this measure as reciprocal.

Respectfully submitted

Robert Taft, Jr.
Taft, Stettinius & Hollister
Counsel for The Recordings
Import Trade Committee

ATTACHMENT A

MEMBERS OF RITC

JEM Records
South Plainfield, NJ

Sounds Good Records
Santa Monica, CA

Tower Records
Sacramento, CA

H.R. 2913

To amend the Tariff Schedules of the United States to provide for rates of duty on imported speedometers used on exercise equipment consistent with those on bicycle speedometers.

DP
Fit for Life

February 11, 1986

Joseph K. Dowley, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Room 1102, Longworth House Office Building
Washington, DC 20515

Re: Written Testimony on H.R. 2913

Dear Committee Members:

In response to your notice inviting comments on H.R. 2913, and on behalf of my company, Diversified Products Corporation, 309 Williamson Avenue, Opelika, Alabama 36803 (hereinafter DP), I once again wish to reiterate DP's strenuous opposition to the passage of H.R. 2913. Our submission and cover letter of August 27, 1985 (copies attached) fully detail the basis for our opposition to H.R. 2913, and our earlier submissions are incorporated herein by reference.

As proposed, H.R. 2913 would result in a catastrophically high duty increase for the speedometers imported by DP for the exercise cycles DP manufactures in the United States. Based upon the 1986 duty rates currently applicable for bicycle speedometers and other speedometers, H.R. 2913 would cause DP's exercise cycle speedometers to be subject to a more than 3000% duty rate increase, up from 1500% based on the rates in effect during our August 27, 1985, submission. As demonstrated in our attached submissions, there is no economic, equitable or historic basis which would justify such a Draconian duty increase on exercise cycle speedometers.

Therefore, on behalf of DP I strongly urge that H.R. 2913 be defeated.

Respectfully submitted,

Richard L. Jenkins

By: Richard L. Jenkins
Vice President Finance & Administration
Diversified Products Corp.
309 Williamson Avenue
Opelika, Alabama 36803
Tel.: 205/749-9001

Enclosures

AIRBORNE

DIVERSIFIED PRODUCTS P.O. BOX 100 OPELIKA, ALABAMA 36803 205 749-9001

DP
Fit for Life

August 27, 1985

Joseph K. Dowley, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Room 1102, Longworth House Office Building
Washington, D.C. 20515

Re: Written Testimony on H.R. 2913

Dear Committee Members,

In response of the Subcommittee on Trade's invitation, and on behalf of my company, Diversified Products Corporation, 309 Williamson Avenue, Opelika, Alabama 36803 (hereinafter D.P.), I wish to submit the following written testimony with respect to H.R. 2913, a proposed bill which would make "bicycle-type speedometers and parts thereof" subject to a duty rate of 19.6%. Currently, speedometers other than bicycle speedometers are subject to a 1.3% rate of duty. D.P. wishes to express its vehement opposition to H.R. 2913.

D.P., a division of GrandMet U.S.A., is an American manufacturer of exercise and recreational equipment. We currently employ approximately 2100 people at our manufacturing facilities in Opelika, Alabama and Compton, California. The exercise equipment field is a highly competitive and price conscious market. There are a large number of domestic exercise equipment manufacturers, as well as importers of exercise equipment with whom D.P. competes. One of the important products that D.P. produces domestically are exercise cycles. Enclosed is a copy of our 1985 D.P. brochure which depicts our domestically produced exercise cycle models on pages 45-48.

D.P. opposes enactment of H.R. 2913 on economic, equitable, and historic grounds. From an economic perspective, although the underlying purpose of H.R. 2913 appears to be the protection of one specialized segment of the domestic speedometer industry, namely bicycle-type speedometers, the ultimate effect of enactment of H.R. 2913 would be to cause substantial economic harm to domestic manufacturers of exercise equipment. Furthermore, while D.P. would be disadvantaged by the enactment of H.R. 2913, Stewart-Warner Corporation, the sole domestic bicycle-type speedometer manufacturer, would be rewarded by Congress for the poor business judgment it displayed in 1977 when it had an opportunity to produce for D.P. the exact exercise cycle speedometers it now wishes to subject to a more than 1500% duty increase, but chose not to produce. Finally, there is no historic justification in extending the high bicycle speedometer duty rate to any other speedometers, since speedometers which are chiefly used on bicycles continue to receive the high "bicycle speedometers" duty rate of 19.6%.

A more detailed discussion of each of the three bases against passage of H.R. 2913, as well as an accompanying topical outline is attached. I am submitting this written testimony on behalf of D.P. in my capacity as Vice President Finance and Administration.

Respectfully submitted,

By: Richard L. Jenkins
Vice President Finance and Administration
Diversified Products Corporation
309 Williamson Avenue
Opelika, Alabama 36803

WRITTEN TESTIMONY SUBMITTED ON BEHALF OF
DIVERSIFIED PRODUCTS CORPORATION
IN OPPOSITION TO H.R. 2913

I. PASSAGE OF H.R. 2913 WOULD SERVE AS AN IMPETUS FOR INCREASED IMPORTATION OF COMPLETED EXERCISE EQUIPMENT AT THE EXPENSE OF DOMESTICALLY PRODUCED EXERCISE EQUIPMENT.

Based upon the high duty rate proposed by H.R. 2913, it is clear that H.R. 2913 is intended to protect the lone domestic manufacturer of bicycle-*type* speedometers, Stewart-Warner Corporation, by imposing a prohibitively high duty rate on imported bicycle-*type* speedometers. The bill hopes to protect one small segment of the domestic speedometer industry by imposing a 19.6% duty rate on imported bicycle-*type* speedometers, rather than maintain the present 19.6% duty rate on bicycle speedometers only, and 1.3% on other speedometers such as those used on exercise cycles.[1] Although such an exorbitant increase in duties may arguably place Stewart-Warner in a more competitive position vis-a-vis imported bicycle-*type* speedometers, domestic exercise cycle manufacturers, such as D.P., would be clearly placed in a disadvantageous position in relation to

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[1] The current tariff schedules provide for bicycle speedometers to be subject to classification under item 711.93, TSUS. Speedometers, other than bicycle speedometers, are classifiable under item 711.98 TSUS. The tariff provisions, in pertinent part, provides:

> Revolution counters, production counters, taximeters, odometers, pedometers, counters similar to the foregoing articles, speedometers and tachometers, all of the foregoing not provided for in subpart C of this part; parts of the foregoing:

* * *

711.93	Bicycle speedometers and parts thereof.......	19.6%
A711.98	Other..	1.3%

The United States Court of Appeals for the Federal Circuit last year affirmed that only speedometers chiefly used on bicycles, not on exercise cycles, were classifiable as "bicycle speedometers" under item 711.93, TSUS. *Stewart-Warner Corp. v. United States*, 748 F 2d 663 (Fed. Cir. 1984). H.R. 2913 would, in effect, overturn the appellate court's decision imported exercise cycles.

Currently, completed exercise cycles which are imported into the U.S. are classifiable under item 735.20, TSUS, and subject to a 5.52% rate of duty.[2] To compete with these low cost imports, domestic exercise cycle manufacturing companies such as D.P. find it necessary to source various exercise cycle components abroad. One of the exercise cycle components sourced abroad by D.P. are speedometers. Because of the physical differences between bicycles and D.P.'s exercise cycles, D.P.'s exercise cycles require a specially designed speedometer known as a double gear hub drive speedometer. Double gear hub drive speedometers permit mounting on the left side of the exercise cycle wheel and have a clockwise speedometer read-out. Double gear hub drive speedometers are not bicycle speedometers, however, because of their physical similarities to bicycle speedometers they would probably be considered bicycle-type speedometers and, therefore, be subject to the high duty rate provided for in H.R. 2913.

The effect of H.R. 2913 would completely reverse the economic incentives which now exist for D.P. to produce exercise cycles in the U.S. Whereas an imported exercise cycle component, such as the double gear hub drive speedometer, carries a lower duty rate than an imported exercise cycle (1.3% vs. 5.52%), thus making off-shore sourcing and domestic production of exercise cycles economically viable, under H.R. 2913 double gear hub drive speedometers would carry a much higher duty rate than completed exercise cycles, which, in their imported condition, already come with speedometers mounted (19.6% vs. 5.52%). The economic balance would shift markedly in the "domestic manufacture vs. import" equation in favor of importing completed exercise cycles. Imported completed exercise cycles would carry a 5.52% duty rate under item 735.20, TSUS. In contrast, the importing of exercise cycle components, such as double gear hub drive speedometers, and maintaining U.S. production facilities would become less feasible with the passage of a bill, such as H.R. 2913, since the duty rate on double gear hub drive speedometers would become prohibitively high.

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[2] Item 735.20, TSUS, provides, in pertinent part:

> Puzzles; games, sport, gymnastic, athletic, or playground equipment; all the foregoing and parts thereof, not specifically provided for....................................5.52%

Put succintly, when it becomes less costly to import the whole article, rather than to import various components and manufacture the product in the U.S., a company, such as D.P., would be compelled to rethink, and conceivably revise its current import and production program with a view towards possibly dropping its domestic exercise cycle production line and simply importing finished exercise cycles. If H.R. 2913 is enacted, it will have the clear effect of making U.S. produced exercise cycles incorporating imported bicycle-type speedometers less cost competitive with exercise cycles which are being imported from abroad. Ironically, by arguably trying to aid one small segment of the U.S. speedometer industry, bicycle-type speedometers, the domestic exercise equipment industry is faced with the prospect of having to become more dependent upon importing an entire exercise equipment line, rather than merely importing selected exercise cycle components and producing the finished article in the U.S.

An illustrative example of how import restraints aimed at protecting one domestic industry can result in unintended severe economic injury to another domestic industry is illustrated by the stainless steel flatware industry. In weighing, and ultimately denying, the stainless steel flatware industry's request for import protection under 19 U.S.C. §2251, the International Trade Commission (ITC) issued a report in which it was noted that the domestic stainless steel flatware industry was hampered in competing with imports because the domestic raw material price for stainless steel was so much greater than that which the importers paid. As noted on page A-72 of the ITC's Staff Report on Investigation TA-201-49, Publication 1536 (June 1984):

> It is evident from the prices quoted on the invoices and from testimony of both domestic producers and importers, that the raw-material cost is an import disadvantage faced by low-end U.S. flatware manufacturers;...According to testimony of one domestic producer, "..., if we were able to buy steel at that price, we would not be here today, because our production lines are automated to the point where if we are able to buy raw material at the same price as our competition, we would be able to compete with any manufacturer regardless of where they are located."

One reason for the higher U.S. stainless steel sheet prices was the import restraints imposed on imported stainless steel sheets. The result -- higher raw material costs for the domestic industry which, in turn, caused most domestic producers to become importers of the low end of the stainless steel flatware market. Id. at 15.

In a similar fashion that may well be the fate that awaits domestic exercise equipment manufacturers if H.R. 2913 is enacted. As the components of exercise cycles become more costly to acquire, domestic manufacturers will, out of necessity, turn to less costly imports of completed exercise cycles, or, alternatively, drop the product line entirely. Thus, rather than protecting a specialized segment of the domestic speedometer industry, bicycle-type speedometers, H.R. 2913 may well be a death knell for U.S. exercise cycle production facilities. In this regard, we are enclosing a copy of a recent news article (Attachment A) which appeared in the Wall Street Journal of August 6, 1985 announcing the closing of Huffy Corporation's Milwaukee, Wisconsin physical fitness product line, which included the domestic production of exercise cycles. Significantly, one of the reasons given by Huffy Corporation for closing its exercise equipment manufacturing facilities was the "sharp rise in low-priced imported equipment from Taiwan and other Far East producers." If H.R. 2913 is passed, it will only add to the domestic exercise equipment manufacturers' woes, and quite possibly force other U.S. companies to close their manufacturing facilities as Huffy Corporation was constrained to do.

II. A SHARE OF THE BICYCLE-TYPE SPEEDOMETER MARKET SHOULD NOT BE LEGISLATIVELY MANDATED, ESPECIALLY WHERE THE BENEFICIARY OF SUCH LEGISLATION INITIALLY TURNED ITS BACK ON SAID MARKET.

As pointed out above, H.R. 2913 has the effect of financially injuring companies, such as D.P., by its enormous duty increase for speedometers used on exercise equipment. Yet the lone beneficiary of H.R. 2913, Stewart-Warner Corporation, could have avoided the need for such legislation had it not purposefully turned its back on producing double gear hub drive speedometers for which it is now seeking a 19.6% rate of duty.

Back in 1977, D.P. requested that Stewart-Warner produce a double gear hub drive speedometer for its exercise cycles, so as to permit a left side mounting on the exercise cycle's wheel with an accompanying clockwise speedometer read-out. In a letter dated December 14, 1977 (Attachment B), Mr. H. C. Stebbins, Jr., Sales Manager of Special Products for Stewart-Warner Corporation, advised D.P. that Stewart-Warner did not produce double gear hub drive speedometers. Instead, Stewart-Warner offered to supply D.P. with a single gear hub drive speedometer (the conventional bicycle speedometer). However, because the read-out of a conventional bicycle speedometer would have to be counterclockwise when placed on the left side of D.P.'s exercise cycle, D.P. chose not to use such speedometers. (On bicycles, as with other vehicles, the normal speedometer read-out is clockwise.). Since the sole U.S. producer was unable and unwilling to supply D.P. with the type of speedometers D.P. desired for its exercise cycles, D.P. was constrained to look elsewhere for its needed specially designed speedometers. Consequently, D.P. sourced the double gear hub drive speedometers outside the U.S. That is how Stewart-Warner lost D.P. as a client. Now Stewart-Warner is seeking to capture the market it rejected some eight (8) years ago by what amounts to customs duty extortion.

Stewart-Warner should not be rewarded for turning its back on U.S.

companies, such as D.P., particuarly when the economic rewards Stewart-Warner is seeking to inure upon its behalf must necessarily be taken from the very company it refused to assist back in 1977. If Stewart-Warner truly wishes to capture a market share for bicycle-type speedometers, it should do so by means of traditional competitive business methods, and not by this flagrant end-run attempt to enact punishing high duty rates for bicycle-type speedometers.

III. THE PRESENT TARIFF STRUCTURE SATISFACTORILY FULFILLS ITS INTENDED DESIGN TO HAVE SPEEDOMETERS CHIEFLY USED ON BICYCLES SUBJECT TO A HIGHER RATE OF DUTY THAN OTHER SPEEDOMETERS.

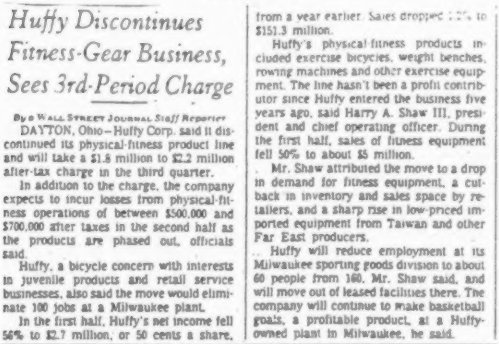
From a purely historical perspective, there is no justification for changing the current tariff rate structure for speedometers. The current speedometer tariff provisions were enacted as part of the Tariff Schedules Technical Amendments Act of 1965. The basis for the 1965 change rested on the fact that Stewart-Warner believed that bicycle speedometers, which were subject to the higher speedometer duty of the 1963 enacted TSUS, were apparently evading the intended higher duty rate. The reason for this was because speedometers which were merely "suitable" for use on highway type vehicles were classifiable at a lower rate of duty. As a consequence, speedometers which were actually used on bicycles were being classified based upon their suitability of use on highway-type vehicles, rather than their actual use on bicycles. By means of the Tariff Schedules Technical Amendments Act of 1965, the TSUS was modified so that bicycle speedometers had a separate tariff break-out, item 711.93, TSUS, with its accompanying higher duty rate, and all other speedometers fall within the ambit of 711.98, TSUS, with its lower speedometer duty rate.

Having successfully closed what it perceived as a loophole in the tariff schedules, Stewart-Warner is now apparently intent on enlarging the embrace of the bicycle speedometer high duty rate. No longer satisfied to encompass only such speedometers that are chiefly used on bicycles, Stewart-Warner is now seeking to have all speedometers which resemble bicycle speedometers, regardless of how they are actually used, subject to the higher duty rate. In effect, the "suitability of use" test which Stewart-Warner so bitterly complained was undermining the classification of speedometers actually used on bicycles, is being resurrected in a more odious form by Stewart-Warner via H.R. 2913, but not for purposes of closing a tariff loophole, but rather for the purpose of ensnaring more and more speedometers chiefly used on bicycles. Thus, what had been designed in 1965 as a very precise closing of a classification loophole, would, under H.R. 2913, be extended much further than its originally intended purpose and, in fact, would subsume many types of speedometers under the high bicycle speedometers duty rate even if such speedometers were never used or even capable of use on a bicycle, as long as they merely resembled a bicycle speedometer. Such an expansion of the bicycle speedometer high duty rate has no historical justification and should not be permitted.

CONCLUSION

Wherefore, extension of that current bicycle speedometer high duty rate of 19.6% to those types of speedometers not chiefly used on bicycles has no econimic, equitable or historic justification, H.R. 2913 should not be enacted into law.

Attachment A



Huffy Discontinues Fitness-Gear Business, Sees 3rd-Period Charge

By a WALL STREET JOURNAL *Staff Reporter*

DAYTON, Ohio—Huffy Corp. said it discontinued its physical-fitness product line and will take a $1.8 million to $2.2 million after-tax charge in the third quarter.

In addition to the charge, the company expects to incur losses from physical-fitness operations of between $500,000 and $700,000 after taxes in the second half as the products are phased out, officials said.

Huffy, a bicycle concern with interests in juvenile products and retail service businesses, also said the move would eliminate 100 jobs at a Milwaukee plant.

In the first half, Huffy's net income fell 56% to $2.7 million, or 50 cents a share, from a year earlier. Sales dropped [illegible] to $151.3 million.

Huffy's physical-fitness products included exercise bicycles, weight benches, rowing machines and other exercise equipment. The line hasn't been a profit contributor since Huffy entered the business five years ago, said Harry A. Shaw III, president and chief operating officer. During the first half, sales of fitness equipment fell 50% to about $5 million.

Mr. Shaw attributed the move to a drop in demand for fitness equipment, a cutback in inventory and sales space by retailers, and a sharp rise in low-priced imported equipment from Taiwan and other Far East producers.

Huffy will reduce employment at its Milwaukee sporting goods division to about 60 people from 160, Mr. Shaw said, and will move out of leased facilities there. The company will continue to make basketball goals, a profitable product, at a Huffy-owned plant in Milwaukee, he said.

Attachment B

STEWART-WARNER CORPORATION
ALEMITE AND INSTRUMENT DIVISION
1826 DIVERSEY PARKWAY · CHICAGO, ILLINOIS 60614 · 312/883-7461

HERBERT C. STEBBINS, JR.
SALES MANAGER
SPECIAL PRODUCTS

December 14, 1977

Mr. James Wilborn
DIVERSIFIED PRODUCTS CORPORATION
P.O. Box 100
309 Williamson Avenue
Opelika, Alabama 36801

Dear Jim:

Attached please find our quotation for our standard exerciser bicycle speedometer set-up....the same that you bought from us a year or two ago. Please note that these are 1978 prices and we hope, at this point, firm for twelve months.

I want to point out that this set-up includes a single gear axle drive with a counter-clockwise head. I believe that you are currently using a double gear axle drive which reverses the cable direction and permits the use of a clockwise reading speedometer head.

At this point in time, we do not have the dual gear drive, however, we are considering tooling this unit.

I am enclosing a copy of our current catalog showing the various models of bicycle speedometers that we currently manufacture for general distribution. Any of these components could be considered for use on an exerciser bike, for example, the head featuring the reset odometer, the tire drive unit in place of the axle drive, etc. Some of the exerciser people are using the reset odometer as a "DeLuxe" feature.

I want to visit with you people in Opelika one of these days, and will be in touch with you after the holidays to set up an appointment. In the meantime, should you have any questions, please do not hesitate to call.

Cordially,

STEWART-WARNER CORPORATION

H. C. Stebbins

H. C. Stebbins, Jr.

dm

Encl.

ALEMITE INDUSTRIAL LUBRICATING EQUIPMENT · FLUID MATERIALS HANDLING EQUIPMENT · AUTOMOTIVE SERVICE EQUIPMENT · HYDRAULIC COUPLINGS AND HOSE
STEWART-WARNER SPEEDOMETERS · TACHOMETERS · GAUGES · FLEXIBLE DRIVE SHAFTS · ELECTRIC FUEL PUMPS · INDUSTRIAL BALANCING EQUIPMENT

LAW OFFICES
TANAKA RITGER & MIDDLETON
1919 PENNSYLVANIA AVENUE, N. W.
WASHINGTON, D. C. 20006

February 11, 1986

Joseph K. Dowley, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: H.R. 2913, a Bill to amend the Tariff Schedules of the United States to provide for rates of duty on imported speedometers used on exercise equipment consistent with those on bicycle speedometers.

Dear Mr. Dowley:

We are submitting this statement on behalf of our client, NS International, Ltd. (NSI), a U.S. importer of exercycle speedometers for use on stationary exercise equipment, to express opposition to H.R. 2913.

H.R. 2913 would amend the Tariff Schedules of the United States (TSUS) by replacing tariff item 711.93, which presently covers imported "bicycle speedometers and parts", with tariff item 711.92, which would cover imported "*bicycle-type* speedometers and parts thereof" (emphasis added). The rate of duty applicable to item 711.93, currently 18.3% *ad valorem*, would remain the same under proposed line item 711.92. The purpose of this bill is to require that imported exercycle speedometers used on stationary exercise equipment, which are presently classified by the U.S. Customs Service under tariff line item 711.98, "other", currently dutiable at 0.6% *ad valorem*, be classified instead under line item 711.92 so that such speedometers would be subject to the substantially higher rate of duty applicable to speedometers used principally on bicycles.

The main proponent of this bill, the Stewart-Warner Corporation, a U.S. manufacturer of "bicycle" speedometers, is seeking to achieve through legislation what it could not obtain through administrative and judicial review of a Customs practice of classifying double-gear hub drive speedometers (double-gear speedometers) used on exercycles, under tariff item 711.98, "other". All double-gear speedometers imported by N.S. International are sold exclusively for use on exercycles.

On November 19, 1984, the United States Court of Appeals for the Federal Circuit (CAFC) in Stewart-Warner Corporation vs. United States upheld the Customs Service classification practice with respect to double-gear speedometers. The CAFC held that Customs' practice of interpreting tariff item 711.93 as a "use" provision providing only for speedometers that are "chiefly used on bicycles" is legally proper. The double-gear speedometers, which this bill would have classified under TSUS number 711.92, are used exclusively on exercycles except for fugitive use on bicycles. In this regard the CAFC opinion stated as follows:

> The lower court found that this speedometer (double gear) is "used primarily in conjunction with exercisers, though it is perfectly suited for use on bicycles." The presumptively correct Customs Service classification found that the speedometers in question are chiefly used on exercisers, not bicycles, with only a fugitive use on bicycles* (emphasis added).

Therefore, this bill would reclassify a speedometer which under existing law and in commercial practice is not a bicycle speedometer as a "bicycle-type" speedometer. Clearly, as the CAFC held there is no support in the legislative history to justify such a reclassification. This bill, if passed into law, would be particularly inequitable in that double-gear speedometers were first developed and marketed commercially in the United States by Japanese manufacturers.

Further, the passage of the bill, according to our major exercycle manufacturer customers, Allegheny International and Diversified Products, may encourage the increased importation of complete exercycles by domestic exercycle manufacturers whose cost of importing an important component part would be sharply increased under this bill. The current MFN tariff rate on imported exercise equipment is 5.04 percent advalorem (TSUS item 735.20) and zero for imports from GSP-eligible countries other than Taiwan. Therefore, if faced with a high rate of duty (18.3 percent) on speedometers, domestic exercycle manufacturers could find it more economical to import the complete unit rather than to compete with finished imported units which enjoy a significant tariff advantage. And as the Administration witness, who testified in opposition to this bill before the Trade Subcommittee in its hearing on this bill February 6, 1986, stated, there are 13 known domestic manufacturers of exercycles but only two domestic manufacturers of so-called "bicycle-type" speedometers.* With so many more U.S. producers who will be prejudiced by this bill than benefited, sound public policy objectives of seeking net increases in domestic sales revenues and employment will not be served.

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* S.O. Stewart Warner Corp. v. U.S., U.S. Court of Appeals for the Federal Circuit No. 84-1041 (1984).

We submit that if Stewart-Warner is facing economic difficulties because of import competition from imported double-gear speedometers, the proper channel for redress of their difficulties is the "import relief provision" (section 201) of the Trade Act of 1974, as amended, or other U.S. trade law provisions and not a self-serving amendment to the Tariff Schedules.

In conclusion, as has already been stated to this Committee by domestic manufacturers of exercise equipment, the principal effect of the enactment of this bill would be to impose substantially higher costs on U.S. manufacturers of exercycles without bringing any tangible benefits to Stewart-Warner or any other domestic manufacturer of "bicycle-type" speedometers.

Accordingly, on behalf of NS International, Ltd., and its U.S. customers, we strongly urge that the Committee not accept this bill.

Respectfully submitted,
NS INTERNATIONAL, LTD.

By: H. William Tanaka
H. William Tanaka, attorney

---

* Mr. Louis Murphy, Acting Director, Office of Industry Assessment, International Trade Administration, U.S. Department of Commerce.

SPORTING GOODS MANUFACTURERS ASSN.

Respond to:

MARIA DENNISON
Washington Office
1625 K Street, N.W.
Suite 900
Washington, D.C. 20006
(202) 775-1762

Board of Directors

Chairman of the Board
GEORGE DICKERMAN
Spalding Sports Worldwide

Vice Chairman
CALVIN JAMES
Diversified Products

Secretary/Treasurer
GEORGE D. GODFREY
Sports and Leisure International

ROBERT F. BURROWS III
Rawlings Sporting Goods Company

JAMES R. CORBETT
Bike Athletic Co.

JAMES S. DAVIS
New Balance Athletic Shoe, Inc.

FRITZ deBEER, JR.
J. deBeer & Son, Inc.

FRANK HALL
Russell Athletic

SHARP LANNOM
DeLong Sportswear

ROBERT MUELLER
Nike, Inc.

MICHAEL G. VINEYARD
Cramer Products

A.C.B. WELLS
Jelinek Sports

HOWARD J. BRUNS
President &
Executive Officer

Executive Office
200 Castlewood Drive
North Palm Beach
Florida 33408
(305) 842-4100

The Honorable
Sam M. Gibbons, Chairman
Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
Washington, D. C. 20515

COMMITTEE ON
FEB 13 1986
RECEIVED
WAYS AND MEANS

Dear Congressman Gibbons:

In response to your notice inviting comments on H.R. 2913, and on behalf of exercise bike manufacturers of the Sporting Goods Manufacturers Association, I wish to express strenuous opposition to passage of H.R. 2913. The bill's effect would be to increase the duty on imported speedometers designed for and used exclusively on stationary exercise equipment from 1.3 percent to 19.6 percent. In the case of imports from GSP-eligible countries, the duty would be increased from zero to 19.6 percent.

As we have testified at previous hearings, the sporting goods industry is struggling with a $4 billion trade deficit and the ability to keep American companies producing in the States. Our foreign competition in the Orient has become sophisticated enough to produce finished goods industries that effectively compete with U.S. goods. To retain American jobs and control of production, it has become necessary for segments of the sporting goods industry to import component parts for the production of finished goods in the U.S. Enactment of H.R. 2913 would result in the transfer of production and jobs away from America and to the Orient.

Domestic exercise bike manufacturers would be clearly placed in a disadvantageous position in relation to finished imported exercise cycles. Currently, there is a duty rate of 5.5 percent on completed exercise cycles imported into the U.S. If a duty of 19.6 percent were to be placed on imported speedometers, as H.R. 2913 proposes, there would be no economic incentive for domestic manufacturers to produce exercise bikes in the U.S..

At the very least, 10 U.S. exercise bike producers would be compelled to change their import and production programs, with the view to dropping their domestic exercise cycle production and importing finished exercise cycles. It makes no sense for a domestic producer of exercise bikes to pay a 19.6 percent duty on imported speedometers to finish an exercise cycle in the U.S., when he would only pay a 5.5 percent duty on importing a completed exercise cycle from the Orient.

-more-

Sporting Goods Mfrs. Assn.
H.R 2913
House Ways and Means Cmte.

There appears to be no justification for changing the current tariff rate structure for speedometers used exclusively on exercise bikes. Speedometers designed for exercisers are never used on bicycles, which is the purported concern of the Stewart Warner Company, the backer of this special interest legislation.

Enactment of H.R. 2913 would satisfy the interests of one company at the expense of an entire industry segment. Its passage would result in the loss of hundreds of American jobs in towns from States that cannot afford any higher unemployment. As a result, it would also adversely impact the tax base of already disadvantaged American communities, and Congress would be responsible for giving away an American industry segment to our foreign counterparts, with no gain in return. In the long-run, Stewart Warner would not benefit from the proposed legislation, and it would have killed a domestic industry in the process of what amounts to a customs duty extortion.

In conclusion, Mr. Chairman, there is no economic or historic justification for equalizing the rate of duty between speedometers imported for bicycles and that used on exercise cycles. An expansion of the bicycle speedometer rate of duty of 19.6 percent to include exercise cycles is a Draconian response from a company that cannot compete using traditional business methods, especially when the speedometers affected by H.R. 2913 are incompatible to and not used on bicycles.

We request that our written statement be inserted into the Hearing Record.

Respectfully submitted,

Maria Dennison

Sporting Goods Manufacturers Assn.
Maria Dennison, Vice President

Ajay Sports
Delavan, Wisconsin

Diversified Products
Opelika, Alabama

Nautilus For The Home
Lake Helen, Florida

Walton Manufacturing
Dallas, Texas

Nautilus Sports Medical Ind.
DeLand, Florida

Olympia Sports Products
Longview, New York

Roadmaster Corporation
Olney, Illinois

Universal Gym Equipment
Cedar Rapids, Fla.

Vitamaster Corporation
Lincolnton, North Carolina

Excel
Pico River, Ca.

H.R. 3019

To amend the Tariff Schedules of the United States to permit the importation of furskins from the Union of Soviet Socialist Republics.

JOINT STATEMENT OF HON. JOHN BREAUX AND HON. DON YOUNG

Mr. Chairman, we are submitting this written testimony to express our concern regarding H.R. 3019. This bill will repeal the embargo that has been in effect for the last 34 years prohibiting the importation of seven types of furs from the Soviet Union. Similar legislation was passed a few years ago which permitted the importation of certain furs from China. To date, there do not appear to be any adverse impacts resulting from the importation of furs from China. However, a Department of Commerce analysis indicates that the domestic ranch mink industry may eventually be adversely affected by removal of the embargo because Chinese production and exports of mink have grown rapidly since that time.

The Soviet fur industry, on the other hand, is the largest producer of fur in the world and much more sophisticated than that of the Chinese. Thus, an increase in fur imports from the U.S.S.R. could have a significant effect on the domestic fur market, especially when compounded by the increased imports from China.

Fur farms are important to the economies of many states. A deluge of Soviet furs, especially mink and fox, could lead to the demise of many American fur farms, especially at the present time because pelt prices are already depressed and the strength of the U.S. dollar is currently impeding U.S. exports.

To exemplify our concern, in the late 1940's Soviet fox fur flooded the U.S. market and depressed domestic prices to such a level as to make trapping uneconomical in some areas. If this were to recur, trappers could once again be excluded from the U.S. market. Impacts could be even greater today than in the 1940's due to the decline in prices of furs such as mink and muskrat. Because of the decline in the price of these furs, many trappers have begun to target on marten as its price has been stable or increasing. If H.R. 3019 were to be enacted, trappers harvesting all of these species may face serious economic hardships due to the loss of markets caused by an influx of Soviet furs.

Not only is trapping a profession that provides significant economic benefits to people in rural communities (nearly 750,000 trappers in the U.S. depend upon trapping as an additional source of income ranging between $4,000 and $10,000 per year), but it is also an important wildlife management tool. If trappers had no economic incentive to trap, states would be forced to expend additional funds on wildlife management programs, thus resulting in a double economic penalty to U.S. citizens.

The Department of Commerce's Statement of Purpose and Need indicates that commitments reciprocally made at the May meeting of the Joint U.S.-U.S.S.R. Commercial Commission are expected to have a positive economic impact on the United States. However, a self-reliant American industry such as the fur industry should not be sacrificed as a concession to the Soviet Union before the potential impacts are known.

We understand that the Soviet fur industry is mature and that much of the Soviet furs are consumed internally; however, we are concerned that production for domestic consumption could be converted to export production in order to acquire U.S. dollars. Our concern surfaces in a report by the Klondike-International Fur Trading, Ltd. They state that the "U.S.S.R. is attempting to use its mink crop for domestic manufacture and to increase its dollar holdings by exporting more mink. They are actively lobbying to lift the U.S. mink import ban so they can increase their sales in this country. While export of fur is insignificant for the American export total dollar figure, fur export is vital for the U.S.S.R., and is one of the largest dollar revenue exports in the Soviet Union". In addition, Soviet fur garments already come into the United States. In 1984, $10.2 million worth of fur garments were imported from the Soviet Union -- up from $6.4 million in 1980.

At this writing, we have received no information from the Department of Commerce as to what the expected levels of Soviet exports to the U.S. might be. We have received a Department of Commerce analysis that states there will be no significant impact on the American fur industry, although there is no hard data to back it up. One argument states that the U.S. fur industry exports approximately 80 percent of their furs, therefore, they already compete with Soviet furs in the world market. However, these figures can be deceiving as many U.S. furs go to Canada for auction and are thus considered exports. U.S. furriers buy much of their fur in these Canadian auctions (some of which is U.S. fur) and it is then considered an import when it is brought back to the United States.

We support the Administration's efforts to increase and strengthen our trade relations with the Soviet Union. It is important to develop a more constructive working relationship with the U.S.S.R. and to improve the market access of U.S. firms. We understand that U.S. export contracts with the Soviet Union have increased as a result of Secretary Baldrige's meetings in May with Soviet Foreign Trade Minister Patolichev. Nevertheless, we still have some concerns regarding the lifting of the current embargo on Soviet fur skins. There is a complex interrelationship involving fur prices, trapper activity, and state wildlife management programs that could be affected by the lifting of the embargo. Without sufficient trade data, we do not know what the effects will be.

House staff has worked closely with staff from your office and from the Department of Commerce to identify the existing data gaps. As a result of this cooperative effort, some of our concerns have been addressed, although additional information is still necessary. As we stated previously, we have no information as to the projected levels of Soviet fur exports to the U.S. Discussions with the Soviets regarding the nature and level of fur exports could alleviate some of our concerns, as well as eliminate the possibility of market disruption recurring.

Until such time as Soviet intentions are known, we remain opposed to this legislation. We understand that this legislation is very important for U.S./U.S.S.R. relations but do not think that it is unreasonable to request from the Soviets their projected exports to the United States.

We believe that action should be delayed on H.R. 3019 until such time as Soviet intentions are known, or until further trade information is obtained from the Department of Commerce.

Also, to allay our fears, we have requested that, if this bill becomes law, the Secretary of Commerce Baldrige write a letter to Congress stating that if Soviet exports adversely affect the U.S. fur industry, he will bring the issue to their attention and try to resolve the problem before permanent damage is done. As of this time, he has not agreed to such a letter. Mr. Chairman, we ask the Committee's support on this issue. It is a small request that will, to a degree, ensure the viability of a domestic industry worth over $200 million. Thank you, Mr. Chairman.

# # # # # #

ROBERT H. MICHEL
18TH DISTRICT ILLINOIS

H-232, THE CAPITOL
WASHINGTON, DC 20515
225-0600

Office of the Republican Leader
United States House of Representatives
Washington, DC 20515

ccc

February 6, 1986

RECEIVED
FEB 1 [illegible]
Ways and Means
Subcommittee on Trade

Honorable Sam Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Sam:

As you are aware, the United States government has, in the past year, embarked on a mission to increase non-strategic trade with the Soviet Union. The Secretary of Commerce made two visits to the Soviet Union in 1985 and as a result, the U.S. - U.S.S.R. Commercial Commission last May signed a trade agreement for the first time in seven years. Greater numbers of U.S. business executives are traveling to the Soviet Union in hopes of signing contracts.

U.S. firms signed almost $200 million worth of contracts in 1985, compared to less than $100 million in 1984. In fact, Caterpillar Tractor recently signed a contract to sell 200 tractors and 39 pipelayers to the Soviet Union. This agreement alone could be worth as much as $80 million. I know this is important to the people of my district, and also know that Americans throughout the country can benefit from increased U.S. - Soviet trade.

As an outgrowth of the Commercial Commission meeting last May, the Administration agreed to recommend legislation to lift the 34-year-old ban on the importation of various furskins into the United States. The bill, H.R. 3019, which you introduced by request on July 17, 1985 is now awaiting consideration in your subcommittee. All data I have seen suggests that lifting the ban would have very little impact on the domestic fur industry. At the same time, it would demonstrate our willingness to remove a long-standing irritant to the Soviet Union. I believe we should make every effort to increase our non-strategic trade with the Soviet Union because of the obvious advantages this provides our business and industries.

Passage of this legislation will send a message to the Soviets that we are sensitive to their concerns and willing to cooperate in the further development of increased trade between our two nations.

Sincerely,

Bob

Robert H. Michel
Republican Leader

THE WILDLIFE LEGISLATIVE FUND OF AMERICA
To protect the Heritage of the American Sportsman to hunt, to fish and to trap.

1612 K Street, N.W.
Suite 1101
Washington, D.C. 20006
202/466-4407

STATEMENT IN OPPOSITION TO H. R. 3019

By

THE WILDLIFE LEGISLATIVE FUND OF AMERICA

Mr. Chairman:

The Wildlife Legislative Fund of America (WLFA) is opposed to H. R. 3019 because of its potential for devastating the fur farming and fur trapping industries in the United States. Fur prices are already seriously depressed.

The WLFA is a non-profit organization whose purposes are to protect scientific wildlife management practices and to protect the interests of American sportsmen and sportswomen who hunt, fish and trap. The WLFA is an association of conservation organizations with an aggregate membership of 750,000. Among these members are organizations committed to the conservation of our fur-bearing wildlife resources. They include Fur Takers of America and the National Trappers' Association. The WLFA shares the concerns expressed by these and other domestic fur interests regarding H. R. 3019.

H. R. 3019, if passed, will amend the tariff schedules of the United States to permit the importation of seven Soviet furskins that have been banned from importation into the United States since 1951. By lifting the embargo Congress will be allowing Soviet mink, kolinsky, ermine, muskrat, marten, fox and weasel to compete with our domestic furs.

Presently there is no substantive data available regarding Soviet fur production. Nor is there any indication of projected levels of Soviet fur exports to the United States. The WLFA has requested such information from the U. S. Department of Commerce, as have several members of Congress and non-governmental organizations. Nothing substantial has been received. It is, therefore, not possible to predict what the effects of lifting the ban will be on our markets. In light of this, we cannot support this measure.

Specifically, our concerns rest with the potential for a sudden flood of Soviet furskins into the United States. Should this scenario evolve, the effects on fur farmers and trappers could be devastating. The impact, however, would not stop there, in as much as trapping is an integral part of wildlife management and the conservation of our fur-bearing resources. In addition, wildlife managers depend upon trapping to help control wildlife populations--to keep populations in balance with available habitat and to control wildlife damage. When fur prices are low there is little trapp
When there is little trapping, conservation programs suffer. For example, in the case of muskrat, one
the furskins to be imported under this bill, a s

effect of minimal trapping is loss of farm crops and loss of waterfowl, the young and eggs of which are a staple of muskrat diet. Fox, also to be imported under H. R. 3019, are a significant threat to the American poultry industry, as well as a prime rabies carrier. A flood of Soviet furs could exacerbate these problems in ways not now predictable.

It is our understanding that this bill is a small part of a larger trade agreement reached earlier last year that will increase and strengthen our trade relations with the Soviet Union. H. R. 3019 has been equated to a political bone we've given the Soviets to solidify the entire trade package. This has been done without any supportive data or assurances that our domestic markets will not be threatened. It is inconceivable that the United States government would sacrifice our fur markets, the trapping industry and wildlife conservation without sufficient data and safequard mechanisms.

Officials within the Department of Commerce believe this bill will have little if any effect on our domestic markets. This is clearly an assumption on their part since they have absolutely no data to support such a belief. The potential for devastating our fur farming and trapping industries is real and should be taken seriously by this committee. The WLFA has no choice but to oppose this legislation.

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